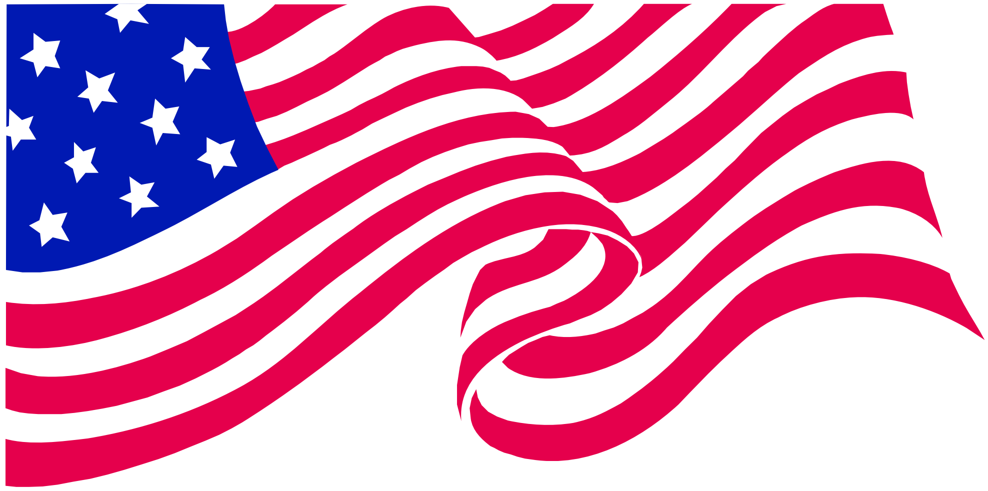

Economic Trends Report

Egypt

May 2007

Embassy of the United States of America

The information in this report covers developments through March 2007.

This report is a product of the **ECONOMIC AND POLITICAL SECTION** of the American Embassy, Cairo, Egypt. The Embassy welcomes questions or comments on this report. Comments should be directed to:

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MAJOR TRENDS AND OUTLOOK

Egypt has seen strong macroeconomic growth for a second consecutive year, after a period of stagnation from 2000 to 2003. Real GDP growth in the fiscal year (FY) 2005/2006 (July 2005 – June 2006), was 6.9%, up from 4.6% in FY 04/05. Key to this growth is the natural gas sector, which grew by 75% in FY 05/06 (in current prices), compared to 20.6% in FY 04/05. Construction grew 18.2% in FY 05/06 compared to 8.7% in FY 04/05, the second fastest-growing sector. In line with expectations, private sector and household-driven demand continued to rise throughout 2006. We expect continued growth, given the government's reform program to promote the private sector, coupled with the boom in the natural gas industry. Unemployment remains a challenge, requiring breakthrough mechanisms for job creation levels exceeding the growth rate of the labor force, about 600,000-700,000 new workers annually. Official unemployment numbers show a slight increase from 10.5% in FY 04/05 to 10.9% in FY 05/06, though independent estimates place it at about double.

Inflation has risen steadily since March 2006, when the Consumer Price Index (CPI) was 3.7%. By October 2006, inflation reached double digits at 11.8%, and most recently hit 12.4% in January 2007. The Central Bank of Egypt (CBE) attributes high inflation to accelerated growth across the economy, combined with the effects of the July 2006 cut in fuel subsidies. Anecdotal evidence reveals price rises across the board in food and beverages, on the back of a second outbreak of Avian Influenza (AI) and a cattle disease during the second quarter of 2006; commodities such as cement and services and communications have also risen. While the pace of inflation slowed in September 2006, a cautionary monetary policy with greater bias toward low interest rates, and a lack of formal inflation targets cause us to believe inflation may not taper off significantly in the near term.

The inter-bank foreign exchange system, established by the CBE in 2004, continues to operate successfully. Current and financial account surpluses ($1.8 billion and $3.5 billion respectively in FY 05/06) are propping up Egypt's international reserves, which grew by $4 billion between January 2006 and January 2007, to the current level of $26.1 billion. Notwithstanding, an effective "sterilization" policy by the CBE has prevented any significant appreciation of the Egyptian Pound (£E). Between January 2006 and January 2007, the U.S dollar exchange rate has remained between £E 5.69-5.74. Changes in this monetary policy are not likely, in view of the government's desire to preserve export competitiveness.

The government announced an 8.0% fiscal deficit for FY 05/06, down from 8.9% for FY 04/05. The improvement reflects accelerated GDP growth, increased petroleum surpluses and one-off boosts in certain revenue items. Assuming the government consistently implements its multi-measure fiscal restructuring package, the deficit should continue to decline in the short term, but more aggressive procedures are required to sustain the trend in the medium and long-term.

Prime Minister Nazif's government has continued the economic reform program begun in 2004. Progress has been made this year in reforming financial and non-financial services, taxes, public expenditure management. The pace of reform has slowed somewhat in response to negative public reactions to controversial reforms, such as reducing subsidies and privatization. Structural changes and facilitation of more broad-based growth seems imperative at this point, to alleviate unemployment and poverty. Clear policies to address these issues are needed to sustain the reform agenda.

Low foreign debt and debt service are strong factors in Egypt's favor, with most debt long-term and concessional. Egypt's foreign exchange reserves cover over ten months of imports. The sectoral outlook of the economy is bright, and we expect that the foreign component – exports and foreign investment, either greenfield or through privatization – will continue to play a major role.

KEY ECONOMIC TRENDS AND ISSUES

Macroeconomic Outlook: Egypt sustained its accelerated level of economic growth for the second consecutive year, realizing real GDP growth rate of 6.8% for the fiscal year ending June 2006, up from 4.5% in FY 04/05. GDP growth for FY 05/06 - the highest in over five years - exceeds the government's 6% target. With annual population growth of 2%, real GDP per capita grew by 4.8%. This high growth in per capita GDP was not matched by similar improvements in per capita incomes or expenditure, given massive income distribution disparities, low labor productivity growth and wide variations in growth levels across sectors.

Inflation, as reflected by the CPI, was under control until March 2006. Since then, however, mass shifts in food consumption towards poultry substitutes amid widespread fears of the AI pandemic, as well as a cattle disease, began feeding into Egypt's CPI. Carrying the highest-weight (+39%) in the index, prices of food and non-alcoholic beverages rose exponentially throughout 2006, reaching 15.9% in December 2006. Price increases were largely felt in protein alternatives, namely meat and fish, the prices of which have more than doubled. The overall inflation rate has similarly continued to rise sharply, with the pace of increase falling off only in November 2006. Between November 2006 and January 2007, inflation rose from 11.8% to 12.4%. Given the reliance of the CPI on a number of distorted prices, such as those for subsidized goods and rent-controlled housing, we believe the actual inflation rate is higher. The government is expected to introduce new base consumer and producer price indices during the first half of 2007. Supply-side inflationary pressures also built up as a result of July 2006 fuel subsidy cuts. In December 2006, energy and transport recorded price increases of 13.1% and 10.4% respectively. The government has consistently cited economic growth as the primary cause of inflation, downplaying the seriousness of the trend. As such, the government has done little policy-wise to reign in inflation, besides issuance by the CBE of some monetary instruments to attempt to absorb liquidity, and two minor increases in policy interest rates towards the end of 2006. Slow monetary policy transmission mechanisms have diluted the effects of these minor changes.

Towards the end of 2006, meetings were held at top government levels to discuss measures for controlling price increases, but so far no concrete action has been taken.

The official unemployment rate increased 0.4% in FY 05/06; reaching 10.9%, up from 10.5% in FY 04/05. Some independent analysts believe real unemployment is double the official figure, adding that underemployment and informal employment could push the figure to 40-50%. Official and private estimates put the number of job seekers entering the market annually at 600,000-700,000. With a backlog of job seekers, actual annual employment demand could be even higher. Changes in the unemployment situation since FY 02/03, as reflected in official numbers, denote an almost static unemployment situation. The government admits that lowering the unemployment rate necessitates a sustained annual GDP growth rate of 6-7% and a total investment rate of 25%, well above the current level of around 18%. At the micro and structural levels, increased employment is constrained by a lack of skilled labor and the qualifications demanded by the job market, rather than a shortage in the number of jobs. According to the World Human Development Report 2005 (the 2005 report is the most recent report addressing literacy in Egypt) more than 40% of the Egyptian labor force is either illiterate or barely literate. The present administration has made quantitative pledges for the creation of 750,000 jobs annually until 2011, more than half of which are expected from the small and medium enterprises (SMEs) sector. While the current administration is encouraging investment in the SME sector, we believe sustained policy focus is needed to also increase investment in basic and specialized education and job training.

By June 2006, external debt was $29.6 billion, up from $28.9 billion the previous year. As a percentage of GDP, external debt was down from 31.1% to 27.6% over the course of the same year, given the significant increase in nominal GDP. The main factor contributing to the increase in external debt was foreigners' purchases of sovereign domestic bonds and bills, which grew from $613.6 million to $1.86 billion between June 2005 and June 2006. Medium and long-term debt increased slightly to $27.9 billion as a result of a $1.25 billion U.S. government-guaranteed bond in September 2005. Over the course of the same year, the debt service ratio declined further from 7.9% to 7.3% – the lowest ratio since June 2002 – with the aid of continued growth in foreign earnings. The bulk of the debt (around 94%) is medium to long-term; about 78% is sovereign.

In March 2005, the reform efforts of the Nazif Cabinet prompted one international ratings institution – Standard and Poor's (S&P) – to upgrade its outlook for Egypt from negative to stable. Despite the upgrade in outlook, S&P affirmed its BB+ long-term and B short-term foreign currency and its BBB- long-term and A-3 short-term local currency ratings for Egypt. S&P mentioned in its statement that the outlook revision reflected improvements in external liquidity, aided by a reinvigorated program of structural reforms and the related strengthening of Egypt's external balance sheet, which lowered external risks emanating from a widening budget deficit and a growing government debt burden. Concerns surrounding the unimproved public debt position prompted another institution – Moody's – to downgrade Egypt's domestic currency long-term government bond rating to Baa1 from Baa3. In its statement, released in May 2005, Moody's Investors Service maintained all other bond ratings and the foreign currency country ceiling, and kept the rating outlook negative. According to Moody's, the downgrade reflected the continued deterioration of Egypt's public finances, which had prompted the agency to assign a negative outlook to the domestic currency bond rating in July 2001. Moody's pointed out, however, that the state of the country's public finances stood in sharp contrast to positive economic developments associated with the bold reformist stance of the new government and the strengthening of its external position.

Ratings institutions have generally maintained their ratings and outlook for Egypt over the course of the past year, citing progress in economic reform and robust external finances in Egypt's favor. Reservations have been expressed though, with regard to the high public deficit, limitations of the banking system and social and demographic challenges. In May 2006, Moody’s upgraded Egypt’s foreign currency country ceiling for bonds to Baa2 as a result of a change in Moody’s methodology.

Fiscal Developments: Significant changes in the country’s fiscal arena have taken place since the Nazif administration took office. The budget accounting methodology has been overhauled, somewhat improving transparency. The cost of some subsidies is now explicitly stated, along with actual level adjustments. The debt burden, however, remains a significant concern, one that will become more acute in the near future as the government proceeds with its plan to re-capitalize the state-owned banks (see section on the banking sector). Notwithstanding, in its budget plan for FY 06/07, the government outlined and submitted to parliament a multi-measure, 5-year fiscal consolidation plan to bring down the deficit by 1% per annum till 2010/2011. Progress on revenue-side reforms is moving faster than expenditure areas given social and political sensitivities.

In submitting the budget proposal for FY 04/05 to parliament, the Minister of Finance announced that the budget was prepared in accordance with the modified *GFSM-2001* (Government Finance Statistics Manual for 2001) of the IMF. The system is intended to provide a more accurate monitor of fiscal flows by relying on an accrual method that records resource flows at the actual time of occurrence. A law was passed in July 2006, establishing a Treasury Single Account at the CBE for the consolidation of all governmental entity bank accounts. The law aims at tightening controls on operating flows within state enterprises, to increase transparency and improve expenditure management. The unified account has helped the government save £E 2.5 billion of the cost of £E 25 billion deposited in the account.

The two abovementioned reforms complement earlier moves in 2002, when the government revised its accounting method for budgetary "out-turns" (i.e., completed periods) to show three increasingly broad measures of the budget and deficits: a narrow budget that includes only line government agencies and programs; a broader definition that includes transfers to or from independent state-owned agencies, and a third definition that also includes the social insurance funds (SIF), currently in surplus because of Egypt's growing working-age population. Earlier estimates of the budget deficit were based on features of the first and second definitions; the government now appears to have adopted the broadest definition as its benchmark for the deficit.

The government revised its estimates of past budget deficits upwards several times in recent years. Based on the government's current reported figures in the new format, the budget deficit declined from 10.5% (narrow) and 9.0% (broad) in FY 02/03, to 9.5% (narrow) and 8.3% (broad) in FY 03/04 and increased slightly to 9.6% (narrow) and 8.9% (broad) in FY 04/05. Preliminary actual figures indicate narrowing of the deficit to 7.9% (narrow) and 8.0% (broad) in FY 05/06. Provisional figures for the first five months of FY 06/07 (July – November 2006) showed a deficit of 1.0% (narrow) down from 1.9% for the corresponding period of FY 05/06. Normally end-of-year transfers from the surplus of the SIFs and other revenue streams result in better annual figures than earlier out-turns might suggest. However, with no concrete spending cuts, final figures could easily bypass projections.

The FY 05/06 budget, as approved by the People's Assembly, included total expenditures of ₤E 217.3 billion (an increase of ₤E 10.4 billion, or 5% higher over the expected figure FY 05/06). It projected total revenues of ₤E 163.9 billion (an increase of ₤E 12 billion, or 7.9% over FY 04/05). The resultant fiscal deficit is ₤E 53.4 billion, or 8% of GDP based on an expected GDP of ₤E 664 billion and a GDP growth rate of 6.9%. In calculating the total required financing for the budget, repayment of local and foreign debt, ₤E 37.6 billion, is added to the overall deficit ₤E 62.24 billion (comprised of the net deficit, ₤E 52.4 billion + acquisition of financial assets, ₤E 8.87). These acquisitions include sales of non-controlling interests in state-owned enterprises which are not counted as privatization receipts according to the IMF's most recent GFS manual. The resultant figure for total financing need is ₤E 99.9 billion, up from ₤E 79.95 billion in FY 05/06. The bulk of deficit financing will come from treasury bills and bonds (₤E 80.1 billion compared to ₤E 52.9 billion in FY 05/06), followed by domestic borrowing in the order of ₤E 16.5 billion. It is noteworthy that zero borrowing was reported from the National Investment Bank (NIB) for the first time in FY 06/07, compared to ₤E 14.1 billion in FY 05/06 and foreign loans registered only ₤E 0.19 billion, compared to ₤E 9.15 billion in FY 05/06. The People's Assembly approved the budget in May 2006. (See the annex for a copy of the budget.)

In addition to traditional social objectives and protection of the poor, the government's stated budgetary priorities include job creation, upgrading public services, modernizing social insurance and pension systems and promoting investments. A new Public Private Partnership (PPP) initiative to involve the private sector in infrastructure construction and provision of basic services has been introduced. In February 2006 the first tender under this scheme was launched for construction and operation of 300 schools. The end-year target is to have 2210 new school projects underway on a PPP basis. Plans are also underway to invite PPP bids for wastewater treatment plants worth ₤E3 billion. The largest proportion of the planned FY 06/07 budget, ₤E 122.7 billion, or 56% of expenditures, is earmarked for the "social dimension," including ₤E 9.1 billion for health and ₤E 27.4 billion for education. Nearly ¼ of the budget, or ₤E 51.4 billion, will go to public sector wages, up from the expected final wage bill of ₤E 45.6 billion for FY 05/06. To support budget cutting efforts, the government has expanded its early retirement scheme, instituted a partial hiring freeze and given employees the option to work part-time.

The government has reformed its management of pension funds in the FY 06/07 budget, by transferring dues paid to the SIFs from the total subsidization, grants and social benefits budget, to the interest expenditure. According to the Ministry of Finance, this will be executed through the issuance of a debenture with the value of lending of the SIFs to the NIB; equivalent to the government's borrowing from the NIB. The debenture is to guarantee the SIF funds, and the government is to pay interest directly to the SIFs rather than through the NIB. This should cut total subsidization, grants and social benefits spending by 12.8%, from £E 67.0 billion to £E 58.4 billion. Nonetheless, continued fiscal pressure is expected as a result of the pension reform plan which will later extend to reforming contributory and non-contributory arrangements. The government is working on the plan with the World Bank; and a new Unified Pensions Bill is in draft.

The budget projects £E 53.8 billion for direct subsidies of basic commodities and services, including sugar, bread, petroleum products and services including transportation and low-cost housing. The figure is up from £E 52.6 billion in FY 05/06. In the past, energy subsidies were classified as expenses in the operating budgets of public sector energy companies. According to the published budget, FY 06/07 subsidies include £E 8.6 billion for basic food products, down from £E 9.7 billion in FY 05/06 (due to the Pound's appreciation and international price changes), £E 8.4 billion for natural gas, £E 8.4 billion for butane gas, £E 15.3 for diesel fuel, £E 3.8 billion for fuel oil, £E 3.6 billion for gasoline, £E 0.5 billion for kerosene and £E 5.1 billion covering – without a breakdown – public transportation, export development, credit facilities and other forms of subsidies such as low-cost housing, farmer and cotton subsidies, pharmaceuticals and student health insurance and industrial zone support.

The final fuel subsidy figure is expected to come below that budgeted in light of a new round of fuel price increases in July 2006, which incorporated a 30% increase in the price of Gasoline -90, a 25% increase in the price of diesel, and 67%, 88% and 25% increases in the price of mazout, kerosene and natural gas for industrial usage, respectively. This follows earlier hikes in 2004. The government also increased the price of natural gas for industrial use from $0.85 to $1.00 per thousand cubic feet. In February 2005, the government introduced new high-octane gasoline fuels – Gasoline 92 and 95 – priced at £E 1.40/liter and £E 1.75/liter, respectively. The prices for these new fuels were not as heavily subsidized as the prices for the lower octane fuels on the market, Gasoline 90 (£E 1.00/liter) and 80 (£E .90/liter). The July 2006 price increase was the first increase in the price of Gasoline – 90 since 1993. The new fuel subsidy cuts saved the government £E 5.8 billion. Efforts to expand the natural gas network are also expected to reduce the cost of petroleum subsidies.

Given that 93% of the gasoline subsidy and 65% of the natural gas subsidy benefits richest quintile of households, price hikes here is less contentious than tackling food subsidies. Nevertheless, a few days after the fuel price hike, the bread subsidy was increased at a cost of £E 1 billion to offset the increase in the price of gas oil used by bakeries. The Ministry of Social Solidarity concurrently stipulated punishments for any violation in bread qualifications, weight or use of flour outside its legitimate purpose.

These and other procedures aimed at rationalizing the food subsidy – such as de-subsidizing certain goods – have not been popular. In October 2006, the Ministry of Social Solidarity began requiring citizens submit a poverty certificate to acquire a ration card. Media reports detailed complaints from low income earners, who claimed that the requirement constituted an additional burden in obtaining even the most basic of rights. A June 2006 World Bank report stated that poverty was growing worse in Upper Egypt while statistics from the same organization estimated that 52% of the Egyptian population was subsisting on less than $2 per day. We do not anticipate any numerical cuts in subsidies directly affecting the lower-income classes in the foreseeable future, but expect the government to further streamline its energy subsidy bill, as recently announced by the Minister of Trade while imposing export fees on steel and cement, the industrial producers of which directly benefit from subsidies of natural gas.

The £E 135 billion-investment budget (£E 29.7 billion from the government, economic authorities, holding companies and public enterprises and £E 105 billion from the private sector – with a 78% weight for the latter) will support the government's sectoral development priorities especially in transportation, energy generation, tourism, agriculture, industry and utilities. The Ministry of Planning and Local Development is reportedly developing a database on investment opportunities open to the private sector across all governorates.

Projected total revenues for FY 06/07 (not including the SIF surplus) increased by 7.9% over the FY 05/06 revised figures to £E 163.9 billion. The new budget classification provides a three-tiered breakdown for revenues: 1) tax revenues of £E 105.6 billion which includes personal and corporate income tax revenues (projected to increase by 17.1% over the FY 05/06 final figure to £E 53.6 billion), customs revenues, (up by 10% to £E 9.6 billion), and sales tax revenues (up 10.5% to £E 16.9 billion); 2) grants, including grants from donor countries and organizations, which are set to decrease by 3.6% to £E 3.5 billion; and 3) "other revenues," which includes £E 35.5 billion in surpluses and profit transfers from state-owned banks, companies and other economic authorities. As a result of a group of tariff cuts in February 2007, customs revenues are expected to be reduced by £E 1.4 billion in FY 06/07. In the latter category, the surplus of the Egyptian General Petroleum Company (EGPC) records about £E 19 billion, down from £E 19.4 billion in FY 05/06. Liberation of EGPC's accounts from the energy subsidy bill and generation of profits on the basis of high international crude oil prices, contributed to a huge increase, almost 125-fold, in its surplus as of FY 05/06. Proceeds to the government from the issuance of the third cellular phone license provided a one-off input to revenues in FY 06/07 worth £E 4.7 billion. Petroleum surcharges and utility fees however, dropped to zero from £E 6.9 billion in FY 05/06. Total "other revenues" are therefore projected to increase minimally by 1.1%, to £E 54.8 billion in FY 06/07.

The budget plan of FY 06/07 projected a growth in total revenues 1.5 times that of the growth rate of expenditures, a slowdown from FY 05/06 and a reversal of growth patterns in FY 03/04 and FY 04/05. The official deficit ratio as a percentage of GDP is also projected to decline between FY 05/06 and FY 06/07, in line with its trend between FY 04/05 and FY 05/06. While partially due to a pick up in the economy, this is also due to the considerable increase in surplus transfers from the EGPC and the Suez Canal Authority, net privatization proceeds, and one-off boosts, such as the third cell phone license revenues. While the changes in the budget accounting methodology partially explain the reversal in growth patterns, actual outcomes must still be considered in projecting and then managing expenditures and revenues by the government. Although tax and customs revenues had been projected at £E 65 billion in FY 00/01 and £E 69 billion in FY 01/02, they in fact remained flat at around £E 51 billion in both periods, as Egypt's recession reduced imports, incomes, and sales. Tax revenues grew to £E 55.7 billion in FY 02/03, but that was still well below budget projections of £E 65 billion. Tax revenues for FY 03/04 and FY 04/05 generated £E 67.2 billion and £E 75.8 billion respectively, still well below the estimated figures of over £E 70 billion and £E 83.2 billion, respectively. This trend however, reversed in FY 05/06, when the actual tax turnout of £E 98 billion exceeded the originally budgeted figure of £E 81.6 billion. This was primarily due to the increase in income tax payments, which exceeded the projected figure by 31.3%, largely as a result of implementation of the new Income Tax Law issued in July 2005 and the increased petroleum surpluses discussed above. Hence, while in FY 04/05, the budget deficit closed the year at 9.6% above the target of 8%, this was reversed in FY 05/06, when the budget deficit fell to 7.9% from the original projection of 9.2%. One-off receipts and revenue-side reforms should support this trend into FY 06/07, but we estimate that, absent additional measures to change expenditure categories from ad hoc to outcome-based in the medium-term and to put public debt on a downward path, actual deficit figures will begin to rise again.

The above analysis points to the need for a comprehensive review of Egypt's fiscal policies, on both the revenue and expenditure side, which has in part been initiated by the government. As noted above, the government has stepped up its efforts to improve its fiscal management. On the basis of government-IMF consultations in the early months of 2005, the government agreed to embark on a multi-year framework to reduce the budget deficit. In May 2006, the People’s Assembly approved this multi-year fiscal consolidation package as presented in the official budget statement. The package aims at bringing down the deficit by 1% of GDP annually for five years: FY 06/07 - 10/11 to 4% in FY 11/12. The various procedures discussed in this section of the report to reform the expenditure and revenue side, were contained in the Financial Statement of the budget as a mix of measures to be phased in gradually starting in FY 06/07. While the announcement of a fiscal consolidation plan has been long called for, the government has not unveiled its priorities or timeline for executing the measures, some of which are bound to have more weighty effects than others, such as measures affecting subsidies, as discussed above. The IMF in its 2006 Article IV Consultations with Egypt predicted that debt levels would remain high for many years relative to other emerging markets. Egypt's expansionary fiscal policy over the past several years has cushioned the impact of the past recession, particularly on the lower classes. If anything, the government is expected to be cautious in changing its expansionary fiscal policy rapidly, given the rising demand for jobs and the need to improve living standards. Real improvements in the regulatory environment that would strengthen private sector development are keenly needed to assist the government in reversing its debt spiral.

The government's "Primary Dealers System," which was launched in July 2004, now has fifteen authorized dealers, including banks and bond dealers, to underwrite primary issues of government securities and activate trading in the secondary market through sale, purchase, and repurchase agreements of government securities. With this system in place, the cost of borrowing and public debt service is expected to decline in the long run. However, the primary dealers system has not yet produced an evident effect on the cost of treasury securities. Other factors, including increased liquidity, have had a greater impact on interest rates for governmental securities. The primary dealers system has nonetheless contributed to activating the bond market at the secondary level. While the government points to a yield curve showing a declining trend since July 2004, it should be noted that the budget figures of FY 06/07 point to a growing burden of public debt incurred through governmental securities, with a 51.6% increase over the expected outlay for FY 05/06. Claims on the government increased from ₤E 15.9 billion in June 2005 (27% year-on-year (y-o-y)), to ₤E 18.4 billion in June 2006, (15.7% y-o-y). Claims on the private sector grew from ₤E 22.8 billion in June 2005 (2% y-o-y) to ₤E 23.9 billion in June 2006, (4.8% growth y-o-y). Growth in claims on the government decelerated in 2006, as in 2005, while private sector credit has exhibited signs of recovering growth in recent months. In December 2006, private sector credit grew by 7.5% y-o-y, a three-year record-high level. Growth in credit to the household sector increased from 11.4% in June 2005 to 28.9% in June 2006. While indicating recovery in domestic demand, a drop in the growth to 24.9% in December 2006 suggests pressures on consumer spending as a result of heightened inflation.

The Ministry of Finance and the CBE have adopted a Master Global Repurchase Agreement Contract, which stipulates the rights, privileges and requirements of undersigning parties to Repurchase Agreements, long-absent from Egypt’s debt management framework. In November 2006, the NIB concluded an agreement with the Commercial International Bank for the sale and repurchase of part of its portfolio of treasury bonds, over a two-week period. This was the first repurchase agreement of treasury bonds to take place in the Egyptian market.

In 2005, the Nazif government re-started revenue reform in conjunction with spending reforms discussed above. In June 2005, parliament passed a new Income Tax Law that created a unified tax rate on corporate profits and across sources of personal income, and reduced rates by 50%. Although the government expected an initial revenue loss, in April 2006, the Minister of Finance publicly commented on better-than-expected results, including a 40 percent increase in submitted tax declarations, and a 227 % increase in proceeds. Improved compliance is attributed to the introduction of the self-assessment principle and simplified tax calculation procedures. While the tax rate was reduced from 32 to 20% for individuals and from 40 to 20% for corporations, the tax base was widened by eliminating deductions and phasing out tax holidays. The Ministry of Finance led an extensive public awareness campaign for its new Income Tax Law, aimed at eliminating the perception of a corrupt and irrational tax-collection system.

The government is also moving forward with reforms of the sales, stamp and real estate taxes. In June 2006, parliament approved amendments to the 1980 stamp duty law, halving the stamp duty tax rate for several products and services, including advertisements, insurance premiums, credit accounts, and loans. In February 2007, the government submitted to parliament amendments to the property tax law, reducing non-agricultural real estate tax rates, while repealing exemptions, thus making all property potentially taxable. Legislation for a full-fledged VAT system is expected at the start of the late 2007 parliamentary round, following assessment of the impact of the stamp and property tax reforms. The VAT will be unified, with final rates likely higher than present sales tax rates. The legislation will do away with most exemptions. The government anticipates that, as with income tax reform, simplification of the sales tax will reduce tax evasion and increase revenue.

On September 12, 2004, a presidential decree promulgated wide-ranging tariff reforms. The amendments brought down the average weighted tariff from 14.1% to 9%. Customs surcharges, as much as 4% of an item's value, were removed altogether. Moreover, the number of tariff bands – reflecting the number of rate categories – was reduced from 27 to 6, immensely simplifying bureaucratic procedures. At the time, the Ministry of Finance predicted a £E 3 billion decline in customs revenues the first year. FY 05/06 revenues are now projected to fall by only £E 1.2 billion as a result of higher imports spurred by lower tariffs. While the reforms were required under Egypt's WTO obligations, the Minister of Finance also stated that they were intended to reduce the cost of production inputs and industrial goods. In the first half of 2005, a sampling of firms across various economic sectors reported declines in input and final product prices, but also reported lower local and foreign sales. In February 2007, the government again cut average customs duties on 1,114 items. The affected items included foodstuffs, raw materials, intermediary and final goods. The changes reduce the weighted average of import tariffs from 9% to 6.9%. Following the reductions, 90% of all items in Egypt's tariff schedule are charged at less than 15%; another 8.5% are not charged at all. The only items whose tariffs still exceed 40% are vehicles that are not electricity-gasoline hybrids, which continue to face a 40% tariff to protect domestic vehicle manufacturers. Tariffs also remain high on clothes, although the rate will be reduced from 40% to 30%. Tariffs on cloth were reduced to from 22% to 10%, yarn from 12% to 5%, and apparel from 40% to 30%. A 2% tariff on nitrogen and phosphate fertilizers was eliminated. The tariffs on appliances and consumer products were cut by 10%, without specifying the new tariff rates. The rate cuts are understood to be an autonomous move – beyond GATT obligations (which according to the government have been met in full) – primarily to address soaring inflation but also to increase competition in the domestic market and support export-oriented manufacturers in the apparel and textiles sector. The decision came a few days after President Mubarak convened the Economic Ministerial Group and called for urgent policies to reign in inflation. The government is allocating £E 150 million to increase the competitiveness of Egyptian manufacturers. As noted above, reductions are expected to reduce customs revenue by £E 1.4 billion in FY 06/07, although the government believes losses will be compensated for by a resulting increase in economic growth and strong import expansion.

Monetary Developments: In September 2004, Egypt established an inter-bank foreign exchange market and in December 2004 formally adopted a convention governing trading in the market, capping Egypt's transition to a unified and liberalized exchange rate system. The foreign exchange surrender requirement of export and tourism proceeds was annulled in December 2004, bringing Egypt into compliance with Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement. These articles call on members to refrain from imposing restrictions on the making of payments and transfers for current international transactions, and from engaging in any discriminatory currency arrangements or multiple currency practices without IMF approval.

The inter-bank market – which allows banks with a shortage in dollars to borrow from banks with a surplus – effectively eliminated the parallel market and contributed to appreciation of the Pound's value, which reached ₤E 5.80/$1 by January 2005, a 7.5 % appreciation. This policy change, combined with strong foreign earnings, further boosted confidence in the Pound. A spree of liquidation of cautionary currency holdings by corporations and individuals led to a drop in foreign currency deposits to 23.6% in 2004/05 from 32.7% at the end of 2003/04. The ratio of foreign currency deposits increased to 24.2% in 2005/06, largely due to the narrowing differential between domestic currency and U.S. interest rates, which declined from over 750 basis points by the end of 2002/03 to around 150-200 basis points currently.

The Pound's appreciation lost pace in 2005, despite continued upward pressures on its value. Between January and June 2005, the rate was static, and since June only minimally appreciated to the level of ₤E 5.73/$1 for buying and ₤E 5.75/$1 for selling. By definition, the normal operation of an inter-bank market should generate daily and weekly variations. The Pound's stability implies that the authorities are reluctant to accommodate a large appreciation, which would challenge external competitiveness, and indicates a resort to "sterilization" operations. The CBE has maintained this policy since mid-2005. Hence, despite recent balance of payments surpluses, the Pound has remained more or less stable. It recorded an average of ₤E 5.70/$1 by January 2007.

The June 2003 banking law mandated a joint government-CBE monetary policy Coordination Council that would set the goals of monetary policy, while leaving the CBE free to determine what monetary tools it would use to implement that policy. Presidential Decree No. 17 was issued in January 2005, establishing the Monetary Policy Coordination Council (MPCC), which first met in April 2005. The MPCC's goal of setting a medium-term inflation target has not yet been achieved.

In June 2005 the MPC set key interest rates, the overnight deposit and lending rates, at 9.5% and 12.5%, respectively – or a 'corridor' of 3%. With this mechanism, the CBE takes overnight deposits at the lower rate and lends overnight at the upper rate. This reduced the size of the inter-bank market, bringing rates closer to the overnight deposit rate. In January 2006, the CBE also reduced the discount rate by 1% to 9%, the first such move since November 2002.

Though inflation rose from 4.4% to 12.4% between April and November 2006, CBE did not raise its rates. In its statements, the MPC has maintained that inflation is still moderate and pass-through, and has noted rising U.S. interest rates, the need to sustain high economic growth and lower costs of government financing as reasons for maintaining rates relatively low. Policy rates were finally increased in November and again in December 2006, by 50 and 25 basis points respectively, reaching 10.75% for lending and 8.75% for deposit. With inflation stabilizing at 12.4% for the first two months of 2007, the MPC maintained rates at these levels at its February 2007 meeting.

The overall decrease in policy rates since the establishment of the corridor system prompted a series of interest rate cuts on bank deposits, but not lending. Interest on one-year deposits has fallen, most recently to 6.9% in December 2006. However, after the November 2006 increase in overnight interest rates, several banks began raising deposit rates by 0.5-0.75%. Interest rates on treasury bills rose to 8.9% in July 2006 and most recently to 10% in January 2007. With double digit inflation, real interest rates are now negative. The rigidity of commercial lending rates in the 13-14% range, coupled with deposit rate cuts, frustrate financial authorities and challenge monetary policy transmission mechanisms. This has also raised questions about the efficacy of policy rate cuts to spur credit for growth purposes. In August 2006, the CBE introduced new savings certificates, offering rates of 7%, 7.125% and 7.5%, for three, six and twelve months, respectively. The certificates, available through the National Bank of Egypt (NBE) and Banque Misr, produced little reaction from commercial banks. Recently, the CBE took additional steps to absorb excess liquidity in the market. In January 2007, CBE began holding deposit auctions with rates as high as 10.6%. Commercial bank response has been weak, however, as the deposits cannot be resold in the secondary market - unlike treasury instruments and CDs - and were subject to taxes.

On the domestic liquidity front, broad money (M2) has grown at a relatively constant pace since FY 03/04, increasing 13.2% in FY 04/05, 13.6% in FY 04/05 and 13.5% in FY 05/06. The net foreign asset position has grown considerably, by 78.8% in FY 04/05 and 64.8% in FY 05/06, owing to increased foreign earnings. Egypt's net international reserves reached a comfortable $21.2 billion in October 2005 and $26.2 billion in February 2007. With the balance of a relatively stable exchange rate, dollarization (foreign currency deposits as a percentage of total liquidity), which were 24.5% in June 2006, inched up slightly to 24.8% in December 2006.

Since taking office in 2003, the Central Bank Governor has repeatedly stated an intention to move toward an inflation-targeting monetary policy, with short-term interest rates as the operational target and changes in reserves the nominal anchor. The CBE initially expected to phase this policy in over a period of two years or more as the staff gained needed expertise. In fact, however, the CBE has not implemented an inflation targeting policy, although progress was made with the introduction of the corridor system. The macroeconomic analysis and forecasting aptitude of the CBE has improved and the MPC now uses six undisclosed CBE-developed inflation indices, in addition to other factors such as credit and money supply growth, to project inflation. CBE's independence and the opaque transmission mechanisms of monetary policy through to the economy must be addressed before the CBE can fully implement this policy. Moreover, the CBE's ability to hire and retain technically qualified staff will be critical to the success of its effort to operate an effective monetary policy. Development of new instruments and procedures for open market operations also will be important. The CBE has embarked on a program to hire more qualified staff, with assistance from the United States Agency for International Development (USAID) and other donors. It also raised salaries for professional staff by 40% in 2004.

Privatization/Asset Management: After years of stalled privatizations, the program was reinvigorated in 2004. Privatization proceeds in FY 04/05 leapt to £E 5.64 billion from £E 0.554 billion in FY 03/04, an annual figure unequalled in the history of the privatization program and higher than the total combined proceeds from the previous four years. Proceeds almost tripled between FY 04/05 and FY 05/06, reaching £E 15.1 billion. For the first half of FY 06/07, proceeds totaled £E 12.6 billion. The number of transactions went from 13 in FY 2003/04 to 28 in FY 2004/05, and 66 in FY 2005/06. Sales this past year include eight Law 203 firms (wholly state-owned), 17 joint ventures and 40 spin-offs of assets or idle land. The last category saw the highest increase over the past two years - 7 transactions in FY 05/06 - from virtually none the start of the program. The new Ministry of Investment, which replaced the Ministry of Public Enterprises, and took over its portfolio of Law 203 companies and joint venture companies, has led the program.

The ministry has changed the emphasis and structure of the privatization program, and used innovative methodology to overcome stumbling blocks. The program was re-dubbed the "asset-management program," with the ministry evaluating each asset in its portfolio – whether a parcel of land, a factory belonging to a company, or a whole company – as a prospective sale feature. This flexible approach enabled the ministry to advance sales in loss-making and structurally problematic firms, such as in the textiles sector. Land sales made up the highest proportion of sales in FY 05/06. Proceeds from sales of public land increased from £E 367 million in FY 04/05 to £E1.295 billion in FY 05/06, or 253%. The biggest of these dominated the news in August 2006, with the sale of 6.3 million square meters in the Sidi Abdel Rahman bay on Egypt's north coast – a flourishing tourism location. The land was auctioned out to Dubai-based Emaar for over £E 1 billion at £E 160.5 per square meter.

The ministry has also abandoned the notion of "strategic" or untouchable firms. These firms – generally profitable public enterprises or joint ventures (JV) – were considered emblematic of strong government presence in certain key economic sectors. The Ministry of Investment now includes these firms in the asset management program. The sale of 30% of Suez Cement Company – the largest Egyptian cement producer – to Italcementi Group for £E 1.9 billion in March 2005 was a case in point. The sale raised the foreign company's stake in Suez Cement to 54%, granting it a majority on the board. In 2005, the Ministry of Investment sold shares in two very profitable energy section firms, Sidi Krir Petrochemicals Co. (SIDPEC) and Alexandria Mineral Oil Company (AMOC); the energy sector had previously been considered "strategic."

Since the early months of 2006, stock market volatility, mounting political opposition, and sectoral sensitivities have obliged the Nazif administration to slow the rapid pace of privatization, and to change tactics to keep the program going. In March 2006, the government postponed indefinitely an IPO of 7% of Egypt Aluminum – the largest aluminum smelter and exporter in Egypt – due to inadequate demand for the shares offered. Similarly the planned IPO for the Middle East Oil Refinery (MIDOR) has not yet taken place.

The local media has vociferously challenged the privatization program as papers across the political spectrum have accused the Minister of Investment of "selling Egypt." Criticism of the rapid pace of privatizations and the lack of transparency on planned sales, asset valuations, and the status of negotiations has also increased. The government has responded by emphasizing that privatization has been government policy since the early 1990s, and is not simply the policy of the new Ministry of Investment. Simultaneously, however, Prime Minister Nazif issued an amendment to the executive regulations of the Public Enterprise Law in June 2006, stipulating that offers of public companies are to be referred first to the Economic Ministerial Group, which would include the popular pro-labor Minister of Manpower, Aisha Abdel Hadi. Such an inter-ministerial group for reviewing privatization plans existed under earlier administrations but fell into disuse in the first years of the Nazif administration, creating the public impression that the Ministry of Investment acted alone in deciding on privatizations. Nevertheless, the criticism has slowed the pace of the program. The outspoken opposition to these policies of the Muslim Brotherhood (MB)-affiliated representatives in the parliament since 2005 has added to the complications for the government.

The sale of retail chain Omar Effendi Co. – with its labor force of 6000 and high-profile history as Egypt's retail flagship - has generated more controversy than any other sale to date. Omar Effendi was re-offered for sale in late 2005, after failed attempts in 1999, 2001 and July 2005. The announcement of a sole bid for the chain in early 2006 – by Riyadh-based Anwal United Trading Company – at £E 504 million, ignited a storm of protest. The government was challenged by an independent valuation committee formed by the Holding Company for Trade and including officials from other retail chains. They set the value of the company by this committee, at £E 1.1 billion, but this was not upheld by the Public Prosecutor's decision on the case, which found the sale to be a liquidation, not a sale of a viable entity. Lengthy negotiations between the government and the buyer were complicated by criticism in parliament and the media, by the appearance of a new bidder in July 2006, who in the end did not honor his commitment. The sale contract was finally signed in November 2006 between Anwal and the Holding Company for Trade for a total of £E 589 million, representing 90% of the company’s capital. The remaining 10% is still owned by the Holding Company of Trade. Anwal was obligated to pay £E 50 million towards early retirement for 1200 employees and a 3 month bonus to the working employees. Anwal is planning to invest £E 200 million to reinvigorate the retail chain, and cover past-due taxes.

Sector-specific issues have also contributed to popular opposition and delays. In the sugar industry, for example, supply shortages and rising prices in the second quarter of 2006 forced the government to cancel the privatization of four companies (Delta, Daqahliyya, Fayoum, and El Nobareyah), in favor of inviting private sector investment in new production lines in government-owned companies as a stop-gap measure. The pharmaceutical industry is similarly price-sensitive given GOE price controls. Since 1991, the government has banned the sale of a controlling stake in any pharmaceutical company, and since 1996, has permitted sales of only 40% stakes in five companies through the stock market. A January 2006 announcement that the government would sell a stake in the Chemical Industries Development Co. (CID) have met with a barrage of accusations that the government is abandoning social concerns. To date no CID shares have been sold, though a manager for the sale has been selected.

Labor issues have arisen in a large number of cases, with strikes at a number of companies. In response, the government has lowered the age for early retirement from 50 to 45 for females, and from 55 to 50 for males. The changes apply to public enterprises only, and not the rest of the government. Also in response to labor complaints, the Minister of Investment has made efforts to incorporate labor representatives throughout sale negotiations.

Beyond those entities in Ministry of Investment's portfolio, the government has sold its shares in key economic sectors, such as banking and insurance. Ten joint venture banks, including Misr International Bank (MIBank) and National Societe Generale Bank (NSGB), Egyptian American Bank, and Commercial International Bank (CIB) – the largest JV bank – have sold off their government-owned shares. The first public bank in Egypt, Bank of Alexandria (BOA) was sold in a highly-competitive auction held on October 17, 2006 to Italy's SanPaolo IMI. The Italian bank paid $1.6 billion (£E 9.3 billion), an estimated 6.05 multiple of BOA's book value. The sale of BOA is the biggest single privatization transaction to date. On December 12, 2006, the share transfer was concluded on the stock exchange with the sale of 128 million shares at $12.60/share. In February 2007 the Ministry of Investment invited investment banks to submit proposals for the IPO of the remaining 15% of BOA's capital, and the allocation of an additional 5% to the bank's employees.

In 2005, the Ministry of Investment selected the Paris-based BNP-Paribas, Egypt's CIB, and the New York-based insurance consultancy firm Milliman Global to evaluate and advise the government on restructuring major state-owned insurance companies, opening the way for their privatization. The government and the consortium signed a contract in February 2006. While the government has declared that all public insurance companies will be sold, industry insiders consider these companies less attractive than greenfield investments, due to overstaffing and the complicating factor of passive real estate investment.

Increased returns from public asset sales have allowed for settlement of outstanding public enterprise debts as well as financial and managerial restructuring. In January 2006, the government announced that it was spending £E 6.9 billion in cash to settle BOA's debts. It also paid state companies £E 1.6 billion to settle some of their debts to other state banks. In mid-December 2006, the government revealed plans to spend £E 9.2 billion from BOA sale funds to shore up the financial positions of 54 other state-owned companies. The money will settle bad debts, owed mostly to state banks, by petrochemical, textile, food, mineral and construction companies. This is the government's second major round of debt settlement and will reduce the total outstanding bad debts of the state banks to ₤E 7.8 billion. The state companies also owe about ₤E 2 billion to private banks. After this round of settlements, state companies will owe ₤E 9.8 billion, down from ₤E 31.5 billion in June 2004.

Further divesting of the government's ownership in key sectors of the economy would attract more foreign investment to modernize production capabilities, allow the private sector to pursue a more active role in economic activity, ensure more efficient allocation of economic resources, and increase local and ultimately external competitiveness. Social and political sensitivities are a growing concern, as economic reforms take hold. Questions have arisen about whether the trickle-down benefits of reform, are offsetting costs, including job losses and increased prices of basic consumer and production goods. Strikes staged in newly-privatized firms also belie claims by the government that performance in such firms has improved. While greater transparency would help ease misconceptions, the Ministry of Investment nevertheless seems to prefer a low-key stance with regard to announcement of future sales. One leading newspaper has reported that the government will announce privatizations on a deal-by-deal basis, suggesting that a more gradualist approach to privatization in the near term. The ministry has underlined that privatization is only part of the economic reform process, not its end. The aim is to build investments in many sectors such as tourism, aviation, telecommunications, agriculture, food. Development of financial services is of particular importance, as it will support needed reforms in privatization-targeted sectors.

Balance of Payments: Preliminary results for the balance of payments (BOP) in FY 05/06 recorded an overall surplus of \$3.3 billion, down from \$4.5 billion in FY 04/05. Net international reserves have continued to accumulate, reaching \$26.2 billion in February 2007, up from \$14.8 billion in June 2004. The current account has shown a surplus for the fifth consecutive year, albeit with declining value. It maintained a surplus of \$1.8 billion in FY 05/06, down from \$2.9 billion in FY 04/05 and \$3.4 billion in FY 03/04, mainly due to growth in the trade deficit. There has been a significant turnaround in the capital and financial account, from a deficit of \$5.0 billion in FY 03/04 to a surplus of \$3.5 billion in FY 05/06. Changes in measurement methodology also influenced BOP figures, as the CBE began including included petroleum section investment in the capital account in FY 04/05.

In FY 05/06, the current account surplus further shrank due to strong import growth (an increase of 25.8% y-o-y) and other payment items, such as government expenditures (up 101% y-o-y). The trade deficit grew from \$10.4 billion in FY 04/05 to \$12 billion in FY 05/06. Oil imports grew by 34.8%, down from a 55.9% growth rate in FY 04/05, despite continued high oil prices. Non-oil imports also increased by 23.7%. The 2004 tariff cuts, cancellation of foreign exchange surrender requirements and a rise in investment-related imports all contributed to the increase in non-oil imports. Exports continued to grow at a healthy pace, rising by 33.4% in FY 05/06, due solely, however, to the increase in oil and gas exports, which surged by 92%. The gradual maturation of natural gas export plans is having a positive effect on Egypt's export figures. After increasing by 32.2% between FY 04/05, merchandise exports dropped in FY 05/06, indicating that growth in investment-related imports has not yet translated into export growth. Higher competition from growing Asian trade giants and increased local demand have also had a dampening effect on exports. In the first half of FY 06/07, performance of merchandise exports showed an improvement, however, growing 45.9%.

The services account remained buoyant. Tourism revenues increased by 12.5% to $7.2 billion in FY 05/06, up from $6.4 billion in FY 04/05. The sector has proven resilient to external shocks since 2004, including a charter plane crash and two terrorist attacks in 2004, the Sharm el Sheikh attacks in 2005, and most recently attacks on resorts in Dahab in April 2006 (see section on tourism). In FY 05/06, the authorities increased their assumed rate of tourist expenditure per night to $85 from $75 in FY 04/05, to reflect a greater inflow of high-spending Gulf tourists. Suez Canal transit revenues, the third largest source of foreign earnings in FY 05/06, recorded a slight increase of 3.4%, rising from $3.3 billion in FY 04/05 to $3.6 billion in FY 05/06.

The capital and financial accounts increased somewhat in FY 05/06, with a surplus of $3.5 billion, up from $3.3 billion in FY 04/05. Foreign Direct Investment (FDI) inflows into Egypt rose 56.6% from $3.9 billion in FY 04/05 to $6.1 billion in FY 05/06. In addition to robust privatization proceeds and increased public land sales, the rise in FDI reflected CBE's decision to include oil and gas investments in the FDI figures in FY 04/05, a change from previous years. The Minister of Investment stated in October 2006 that the non-energy sector was 70% of FDI in FY 05/06, compared with 33% and 20% in the previous two years. The minister predicted that the contribution of the non-energy sector would rise again in 2006/07. The ministry also projected that, despite continued obstacles to investment, expected net FDI will increase to an unprecedented $7.5- $8 billion a year by June 2007. The biggest deal this year was the July 2006 sale of Egypt's third mobile network to Etisalat for £E 16.7 billion ($2.91 billion). Despite an exponential 232% growth in portfolio inflows in FY 05/06, portfolio outflows grew by 235%, revealing purchases of foreign portfolio assets more than offset non-resident acquisitions of Egyptian equity.

Net errors and omissions in the BOP increased to a negative $2 billion in FY 05/06 from negative $1.8 billion in FY 04/05, indicating either an overstatement of inflows or understatement of outflows. The large change in value casts some doubt on the analysis of external accounts and indicates the need for a more accurate monitoring of flows through the banking sector and the CBE. Banking sector representatives have indicated that discrepancies may be a result from over-reporting of oil export proceeds.

Direction and Composition of Trade: The European Union (EU) remains Egypt's largest trading partner, accounting for 37.1% of Egypt's imports and 37.6% of its exports in FY 05/06. Egypt's Partnership Agreement with the EU came into force in June 2004, strengthening the already substantial trade relationship. The U.S. is Egypt's next largest trading partner, and its largest single-country trading partner, accounting for approximately 18.8% of its imports and 30.6% of Egypt's exports in FY 05/06. Asian countries account for around 14.6% of imports and 11.3% of exports. Arab countries account for 9% of imports and take 11.5% of exports. African countries, Russia, British Commonwealth countries and Australia take up the rest.

Egypt's leading merchandise export is crude oil and petroleum products, which spiked from $5.5 billion in FY 04/05 to $10.4 billion in FY 05/06, as a result of revenues generated by liquefied natural gas (LNG) export streams. Egypt's second largest export category is finished goods (steel, textiles and apparel), followed by semi-finished goods (including aluminum and cotton yarn) and raw materials (cotton and other agricultural products). In 2005, steel exports were $1.2 billion. For the first quarter of 2006, steel exports amounted to $202 million compared to $256 million in 2005. Egyptian steel producers are looking beyond the weak domestic market and have benefited from the steady rise in prices of steel products since 2004. Cement producers also continued exporting at high levels, principally to the booming Gulf region. Leading imports include intermediate goods (especially iron and steel products), followed by capital (investment) goods, which grew 61% between FY 04/05 and FY 05/06, reaching $ 7.9 billion. Investment goods imports were $1.5 billion in 2004 and $2.1 billion in 2005. From January to July 2006, imports of capital goods amounted to $1.2 billion.

Chief U.S. exports to Egypt are agricultural commodities (around $1 billion annually), capital goods, and equipment. The value of U.S. exports rose slightly from $3.1 billion in 2004 to $3.2 billion in 2005 but increased significantly to $4.1 billion in 2006. Wheat exports dropped were $190 million in 2005, increasing somewhat to $235 million in 2006. Egypt's exports to the U.S. had averaged $700-900 million in recent years, but jumped to $1.2 billion in 2004 and further to $2.1 billion in 2005. In 2006, Egypt's exports to the U.S. rose further to $2.4 billion. The Qualifying Industrial Zones (QIZ) program between Egypt and Israel is having an effect, with Egypt's exports to the U.S. jumping by 75% between 2004 and 2005. Between 2004 and 2005, Egypt's overall exports to the U.S. grew 14.3%. Clothing, other textiles, crude oil, and oil products are the largest exports. Egyptian steel exports to the U.S. were $314 million between January-November 2006, up from $101 million in the same period of 2005.

Egyptian trade and BOP data can be inconsistent; authorities claim efforts are being made to reconcile such differences. The BOP figures previously included payments made by the government to foreign oil and gas companies for domestic production bought by the government and used in Egypt. This data has been excluded from July 1999 data onwards. They also may include payments for transactions in which the Egyptian participant was a broker for a transaction between two other countries, as in trade figures for Iraq. Finally, BOP figures may report payments made to banks in financial centers (such as New York) rather than recording the ultimate recipient, skewing the individual country trade statistics. Customs figures, on the other hand, appear to understate oil and perhaps other exports. The truth probably lies somewhere between the BOP statistics (always higher for both imports and exports) and customs figures. In reporting bilateral trade with the U.S., we have relied solely on U.S. government statistics. For other countries and regions, we have used a mixture of Egyptian customs and BOP figures and data from Egypt's trading partners.

MAJOR LEGISLATIVE AND REGULATORY DEVELOPMENTS

New legislation passed by the People's Assembly in the 2005/06 parliamentary session and the current 2006/07 session includes the Customer Protection Law, in addition to amendments to the Stamp Tax, Tenders and Bids, and Capital Market laws. Parliament also ratified amendments to securitization principles and Egypt's customs tariff schedule.

Consumer Protection Law: The Consumer Protection Law No. 67 for 2006 was ratified in the People's Assembly in May 2006, coming into effect in August. Executive regulations were issued in November. The law lists the rights of consumers that it protects, based on UN principles of consumer protection, including the right for individuals, as consumers, to participate in consumer organizations and the right to bring suits against producers and service providers. Rights also include the right to health and safety upon consumption and the right to knowledge about purchased products. The law obliges suppliers to accept returns and exchanges within 14 days with a receipt, and stipulates fines from £E 5,000 to £E 100,000 for violations ranging from refusal to return goods to the intentional sale of faulty goods. The new Consumer Law provides for a Consumer Protection Agency (CPA) under the Ministry of Trade and Industry. The new agency will accept filed complaints from consumers and consumer groups. The CPA has a staff of 15 people. The Minister of Trade and Industry appoints members of the CPA's staff.

Stamp Tax Law: In June 2006, parliament amended the 1980 Stamp Duty Law. The reform simplified procedures, and halved the stamp duty tax rate imposed on some products and services. The rate for advertisements published on television, in cinemas and in the printed press was reduced from 36% to 15%. Radio advertisements will be charged 15% instead of 24%, and a new 15% stamp duty tax will be imposed on billboard ads. Taxes on life insurance premia were also reduced from 3% to 1%, while insurance policies on maritime, land and air transportation will be reduced to 10%, down from 15%. The tax on credit accounts and loans was also reduced from 0.01% to 0.0001%, to encourage more private sector activity. The government has also indicated that disputes with the Tax Authority that do not exceed £E 5,000 will be automatically dismissed so as to reduce collection costs. A study by the Ministry of Finance will determine the current as well as expected revenues which will be accrued from the stamp duty tax, as a result of the latest amendments to the law.

Tenders and Bids: In September 2006, the Tenders and Bids Law was amended to streamline contract procedures. The changes shorten the period required for announcing tenders and evaluating bids, lower charges for tender documents, oblige clients to hold pre-bid meetings to clarify terms of tenders, and include model contract terms clearly setting out rights and obligations of contractors. The amendments allow small- and medium-sized enterprises to acquire tender documents at cost. In October 2006, the Tenders and Bids Law was amended, allowing for the disposition of real estate, or licensing its utilization or exploitation by direct agreement with squatters or current occupants.

Customs Tariff: Import tariffs were reduced on 1,114 items, including foodstuffs, raw materials and intermediary and final goods, by a February 2007 presidential decree. This is the second major tariff reduction since Prime Minister Nazif took office. The changes reduced the weighted average of import tariffs to 6.9% from 9%. Following the reductions, 90% of imported goods, including many foodstuffs, raw materials, intermediate goods and some finished goods, such as refrigerators, heaters and televisions, face tariffs below 15%, and other products, around 8.5% of the total, are subject to no tariffs at all. The only items on which tariffs still exceed 40% are vehicles, which continue to face a protective 40% tariff. Clothes also face relatively high tariffs, though the rate was reduced from 40% to 30%. Tariffs on cloth were also reduced to 10% from 22%, and yarn to 5% from 12%. The 2% tariff on nitrogen and phosphate fertilizers was eliminated.

Capital Market Law Amendments: In October 2006, the Ministry of Investment amended the Capital Market Law No. 95/1992, raising required capital for companies working in stockbrokerage; evaluation, analysis, classification of securities; management of securities portfolios and investment funds; and promoting subscription of securities to ₤E 5 million (from the previous requirement of ₤E 250,000). The same amendments also require companies working in the fields of risk capital, direct investment funds and bond brokerage to hold a capital of ₤E 10 million.

In April 2006, Decree No. 141/06 was issued, prohibiting price manipulation and exploitation of internal stock exchange information. The Capital Market Authority (CMA) Chairman issued decision No. 2/2007 in January 2007, setting the legal framework through which selling and repurchasing transactions of bonds – both government and corporate - are executed. In February 2007, the Minister of Investment amended the executive regulations of the Capital Market Law No. 95/1992 to re-regulate rules for purchase for joint stock companies, when the purpose of the purchase is to acquire ownership and management. Under the new rules, an investor will not be able to buy more than a third of a company's total capital or voting rights through the stock exchange or other market mechanisms. An investor seeking to increase his stake must bid for all outstanding shares and convertible bonds, should he seek to buy more than one-third of a company. The new rule reflects international standards and best practices. It improves disclosure and bidding valuations and to protect minority shareholder rights. The investor must have an independent financial adviser if the bidding price is less than the average market price over the previous six months, if shares are swapped or if buying from a shareholder who holds more than 25% of the company's capital.

Securitization Rules: In January 2007, the government amended securitization rules in the executive regulations of the Investment Incentives and Guarantees Law, to make it easier for companies to raise short-term debt. The amendments designate securitization as a non-banking financial service. The amendments allow minimum capital requirement of securitization companies to be set in any convertible currency, and the capital to be deposited at any commercial bank registered with the CBE. At least 50% of companies' capital, must be deposited in the convertible currency. Financial statements must be reported in the same currency as the company's capital.

SECTORAL TRENDS AND PRINCIPAL GROWTH SECTORS

Services: Services account for roughly 50% of Egypt's GDP, with tourism and Suez Canal revenues being particularly important.

Tourism: Tourism is Egypt's largest foreign exchange earner and a key engine of growth. Hotels and restaurants – the key indicators for the sector – recorded the highest growth of any section in 2005/06, at 12.5%. Official figures credit tourism with about 11% of GDP, making it the second largest industry and the second largest employment-provider sector. Tourism arrivals and revenues, which declined sharply at the onset of the war in Iraq in 2003, rebounded strongly shortly thereafter. Despite regional unrest and a number of security/terrorist incidents since 2004, the tourism sector continued to grow and set new annual records. Most tourists came from Europe and the Middle East, including the United Kingdom, which sent more than 1 million tourists, and Russia and Germany, which also sent around one million tourists each.

Figures for 2006 indicate 9.8 million tourists visited Egypt in the first nine months of 2006, up 5.5% from 8.6 million during the same period in 2005. Number of nights stayed increased by 4.9% over the same period, rising from 85.2 million nights to 89 million nights. Revenues for 2006 were up 11.8% to $7.6 billion, compared with $6.8 billion over the same period in 2005.

On April 26, 2006 a terrorist attack rocked the Red Sea coastal resort of Dahab**,** popular with Western and Israeli low-budget tourists, and was also packed with Egyptians enjoying a public holiday. The explosions killed 22 and wounded 150. This was the third attack in the Sinai Peninsula in 18 months. After the Dahab attack, bookings declined 1-2% throughout the country. Late summer tourist arrivals were also affected by regional political conflicts in Lebanon, Iraq and Palestine. The industry, however, has not been significantly damaged, as European tourists continued to arrive in large numbers. Europeans made up 74.4% of total tourist arrivals, followed by Arabs (mainly from the Gulf and Levant) at 13.4%, North Americans at 3.3% and Africans at 3%.

Gulf vacationers are the top-spenders and tend to stay longer than other tourists. Official numbers indicate that the average dollar amount spent by tourists increased from $75 to $85 per day in 2006. Although the total number of Arab tourists dropped 2.8% between November 2005 and November 2006, the number of nights spent by Arab tourists increased 16%, with Lebanese in the lead, followed by Saudi Arabians and Sudanese. Tourists from Qatar increased 26.4% in 2006 compared to 2005, the highest jump among Arab countries. Of the Gulf countries, Saudi Arabia continued to be the biggest source of tourists in 2006, with more than 338,000 visitors to Egypt, a 7.5% increase over 2005. UAE visitors increased 21.8%, Libyans 17.8%, Jordanians 16.9%, Kuwaitis 16.7%, Tunisians 14.7% and Bahrainis 13.4%.

The number of Americans traveling to Egypt in 2006 soared to 228,165, a 16% increase over 2005. The number of Chinese tourists rose in 2006 to 34,813, an increase of 39%

over last year. The Ministry of Tourism anticipates that over 150 million tourists will arrive from China and India alone by the year 2020 and total foreign tourist arrivals will increase to 16 million by the year 2014.

Based on these projections, the Ministry of Tourism plans to open a number of new tourist destinations, and to promote development of new segments of existing tourist sites, improve overall facilities and services, and encourage new investment. The Minister of Tourism is also working on developing new tourism sub-sectors, including medical and conference tourism. Currently planned construction of tourism facilities should be meet expected demand, and will be complemented by modernization of airport structures (see transportation section), and the prospective opening of aviation services to the private sector.

Tourism investment increased significantly in 2006. The recent sale of a 6.2 million square meter plot for $175 million on Egypt's north coast to UAE's E'mar Properties indicates the high level of interest among foreign investors in tourism development in Egypt. Although the government is promoting the north coast, the Red Sea area still attracts the majority of foreign investments. Qatari Diar Real Estate Investment Company is expected to approve the conceptual designs for a new $250-300 million tourist development in Sharm el-Sheikh, including hotels, villas and an aquatic park. Beirut-based Erga is the project's lead consultant. Construction is expected to begin in 2008. The Ministry of Tourism's 20-year investment plan aims to attract other major Gulf construction and development groups to create new resorts and facilities across the country.

With significant government support for the sector, the short- to mid-term outlook for the tourism industry remains bright, but depends on the continued resilience of the sector vis-à-vis potential external shocks, such as regional instability and high oil prices.

Suez Canal: Egypt marked the 50^{th} anniversary of the nationalization of the Canal in 2006. Canal revenues continued their robust performance in FY 05/06, setting a new record of $3.8 billion compared to $3.3 billion in FY 04/05, with the canal accounting for 8.2% of global trade traffic in 2006, compared to 7.4% in 2005. Approximately 18,000 ships passed through the canal in 2006. Increased trade flows from East Asia, especially India and China, are partially responsible for the rise in canal revenues, in addition to high global oil prices, which have made shorter transportation routes more desirable. Official figures estimate revenues from the Suez Canal amounted to 3.5% of GDP in 2006, a 14.2% increase over 2005, making it the third largest source of foreign currency after tourism and remittances. We expect this trend to continue, as oil prices remain high and Asian trade activity grows. A 2.8% increase in Canal tariffs in April 2007 will further increase revenues.

The government plans to spend over $5 billion to upgrade the canal over the next several years. The shipping channel will be deepened by 3.1 meters and widened by 17% to an average of 365 meters. Suez Canal Authority representatives indicate that Egypt will spend $1 billion a year from 2010 through 2015 on the project. These improvements will make the Canal an even more attractive transportation route, enabling tankers carrying 350,000 metric tons (mt) of cargo, equivalent to more than 2 million barrels of oil, to pass through the Canal. At the moment, the maximum cargo is 200,000 mt. Egypt has spent about $800 million on expansion projects since 1980 to accommodate growing traffic.

Banking: Egypt's banking sector reform program continues, bringing about consolidation in the industry and cutting the total number of commercial and investment banks to 36 by the end of 2006 (from 45 at the end of 2005). The competitiveness of and competition among banking units has increased, in part due to the increased presence of foreign banks in the market. The government's plan for banking reform followed recommendations of the joint 2002 IMF-World Bank Financial Sector Assessment Programme for Egypt. The plan called for consolidation, sale of government shares in JV banks and restructuring of public banks – to include resolution of the non-performing loans (NPL) problem – in preparation for privatization. In July 2005, the deadline for banks to meet a new capital requirement of £E 500 million stipulated in the Unified Banking Law of 2003 expired, following a grace period of one year. Since an August 2004, the Central Bank decree regulating capital increase requirements, and requiring capital adequacy ratio of at least 10%, several mergers and acquisitions occurred, affecting approximately 20% of licensed banks. By 2006, 11 small banks had been merged into larger banks and the CBE had begun legal procedures to liquidate branches of three foreign banks that had not met the capital requirement. In June 2006 the Islamic International Investment Bank, United Bank of Egypt and Nile Bank restructured as a private bank under the name of United Bank (UB), with a paid-in capital of £E 1 billion. The three merged banks could not meet their £E 500 million capital requirement and had 920 cases of distressed assets worth £E 5.6 billion. In addition to a capital boost, the CBE granted UB an additional subordinated loan amounting to £E 3 billion to support the acquisition. This was the first time that the CBE established a new banking entity structured as a private bank. The CBE owns 99.9 % of the entity, but its ownership will terminate once the bank's loan portfolio is strengthened and the initiating funds from CBE are reimbursed.

In some cases, such as the merger of MIBank and NSGB, merger and acquisition processes, have been lengthy due to differences in internal bank systems, restructuring needs and problems of distressed assets. Labor disagreements occurred after NSGB purchased MIBank in 2005. The acquisition, valued at around $400 million, prompted mass resignations at MIBank for fear of and in protest against losing the higher employee benefits offered by MIBank. NSGB officials claim that employees who stayed on actually benefited more than those who resigned.

Along with consolidation, the government's reform plan called for divestiture of government shares in JV banks, the proceeds of which were to be allocated for financial restructuring of state-owned banks. To date, ten banks have been divested of public shares, including MIBank; NSGB; Misr-America International Bank; Egyptian-Commercial Bank; Misr-Romania Bank; Suez Canal Bank; Delta International Bank and the Cairo Far East Bank. In 2006, approximately 75% of a large JV bank – the Egyptian-American Bank (EAB) – was sold to Calyon Corporate and Investment Bank, part of the

French Credit Agricole Group. Trading in both Calyon Bank Egypt and EAB was suspended in August 2006 upon completion of merger procedures, and EAB was de-listed from the stock exchange on August 31. Credit Agricole Egypt, the new bank formed from the merger, started trading its shares in September. In February 2006, the government's share of the largest JV bank – CIB – was sold to a U.S. consortium. These divestitures have somewhat changed the position of these banks in the market. CIB moved from first to second place, in terms of market share of loans and deposits; NSGB is now in first. Credit Agricole is now Egypt's third largest private bank.

Government transparency regarding the status of NPLs in Egypt has improved. A January 2006 plan to repay £E 32 billion in public enterprise debt arrears to the banking sector, including £E 25 billion in irregular loans, through an agreement between the Ministries of Finance, Investment and the CBE, has been partially executed. In January 2007, the government announced that £E 16 billion of NPLs owed by public enterprises to public banks, or about two-thirds, had been settled. In addition £E 50 billion in private sector NPLs to the public banks were settled, bring total NPLs resolved to date to £E 66 billion. These settlements build on the January 2006 settlement of BOA's debts of £E 6.9 billion owed by the public sector. Proceeds of privatization sales and divestment of joint venture shares have been utilized in these resolution processes.

Resolution of the NPL problem began in 2004, when the government established an Arbitration Committee and an NPL unit at the CBE to resolve bad debts, handle disputes between banks and borrowers and develop a long-term solution to the NPL problem. The CBE also asked banks to establish their own units to maintain information on NPLs, and monitoring progress on recovery, settlement and write-offs. Although the majority of banks still do not disclose their level of distressed assets, various estimates indicate that NPLs as a percent of total loans is declining and stands on average at 20-25% at present.

Besides settlement of NPLs of state-owned banks, the government has also stepped up efforts to recapitalize these entities. In January 2007, the government announced that the financial positions of the public banks would be bolstered by £E 6 billion in capital increases. Two billion Egyptian Pounds would be allocated to NBE and the rest to the remaining public banks, primarily Banque Misr. Despite these efforts, the financial profile of state-owned banks generally lags behind private banks. The cost of re-capitalization of the public banks has been put at 7-10% of GDP by external estimates, and is a significant fiscal liability. In June 2006, the World Bank's Board of Executive Directors approved a $500 million Development Policy Loan for Egypt for financial sector policy and institutional reforms.

The long-awaited privatization of BOA culminated in an auction held in October 2006. The Italian bank SanPaolo IMI bid $1.6 billion for 80% of BOA, implying $2 billion as the value for 100% of the bank's shares, or 6.05 times book value. Five percent of BOA's shares were reserved for BOA employees and the remaining 15% are to be floated on the Cairo and Alexandria Stock Exchange (CASE). At auction time, BOA's declared asset position was $6.9 billion and total deposits $5.4 billion. In February 2007, the Ministry of Investment invited investment banks to submit proposals for the IPO of the remaining 15% of BOA's shares, and the allocation of the additional 5% to the bank's employees.

Surprisingly, in September 2005 the government also announced the merger of the second and the third largest state-owned banks, Banque Misr and Banque du Caire. The merger was to have created the second largest state-owned bank (after NBE), with assets exceeding £E 130 billion ($22 billion). This move triggered questions about the prospects of privatizing the new entity. The merger was not concluded on the date initially announced, December 31, 2006. In March 2007, the General Assembly meeting of Banque Misr approved its acquisition of Banque du Caire by acquiring 400 million shares at a par value per share of £E 4, in a deal worth £E 1.6 billion. The meeting also approved an increase in Banque Misr's paid-in capital from £E 1.8 billion to £E 3.4 billion.

After NPLs, access to credit by the private sector is the major problem in Egypt's banking system, as the bulk of lending still goes to the public sector. However, some progress has been made this past year. Credit to the private sector grew by 4.9% in FY 05/06, double the 2.2% growth in FY 04/05. Bankers admit that lending is overly conservative, with banks tending to compete for the top, well-known tranche of borrowers. A recent study found that 0.2% of clients account for 52% of bank credit to the private sector and only 17% of all companies have access to bank credit. We believe improvements in private sector lending are necessary for sustaining growth from within the economy and that small and medium enterprises (SMEs) have a significant role to play in this regard. Many analysts conclude that lack of capacity in credit risk analysis, along with high lending interest rates and huge volumes of government debt must be addressed in order for the private sector to gain greater access to credit. One step in improving credit risk analysis was taken in August 2005, when the CBE issued rules and procedures for the licensing of credit bureaus. The first credit bureau, "Egyptian Credit Bureau" or "ESTAILAM," was established in September 2005, under CBE's supervision, and will become operative in 2007.

<u>Capital Market:</u> The stock market rally beginning in 2003 peaked in February 2006, when the benchmark Hermes Financial Index (HFI) hit 69,000. The surge, driven in part by investment from Gulf countries, was supported by strong company earnings growth and improving macroeconomic indicators. Amateur investors – driven solely by the market's momentum in anticipation of short-term profits – had also entered the market in large numbers. In February 2006, however, the CASE entered a correction phase, ignited by a wave of strong corrections in GCC markets, but arguably predictable from a technical point of view. By June 2006, the HFI had fallen to 42,640, but since then has recovered somewhat. On an annul basis, the Egyptian stock market rose 10.3% in 2006, the slowest rate since 2002. The increase, however, is still significant given the challenging first half of the year.

The HFI began regaining value in the second half of 2006, reaching 61,291 points in December 2006, and receding slightly to 59,011 points February 2007. After increasing by tenfold between June 2004 and June 2005, the total value of traded securities per month grew at a far slower pace, reaching £E 12.4 billion in June 2006. Trading volume rose to 9.1 billion shares, up from 5.3 billion shares in 2005. Foreigners' (Arab and non-Arab) participation in trading rose from 27% in 2004 to 30% in 2005 and 2006. Foreign portfolio investment registered a net inflow of $2.8 billion in FY 05/06, up from $831 million in FY 04/05. As of December 2006, the market capitalization of the CASE was approximately £E 534 billion, equivalent to 80.3% of GDP, up from £E 456 billion and 87% of GDP in FY 05/06. In 2006, shares in 407 of 595 listed companies were actively traded, with shares in an average of 95-110 companies trading on a daily basis.

Despite strong earnings growth expectations for Egyptian companies, given the macroeconomic recovery, valuations lower than peer markets and a gradually deepening stock market, revival of the former rally is unlikely. With significant dependence on Gulf retail and Western institutional investors, the market is likely to make moderate gains in 2007, with short-lived bounces until global stabilization is restored. A full recovery would require a restoration of confidence and purchasing power of local investors – some of whom lost 50% of their savings February 2006 – by improving domestic economic conditions and reducing risk expectations. A shift in the role of domestic investment from an amplifying factor of external moves, to a driving factor, is not likely in the near future.

In response to the 2006 correction, the government issued a number of decrees addressing illegal and unprofessional market practices. While exogenous factors had certainly triggered the crash, anecdotal evidence suggests some local CASE operations had also created imbalances. A case in point is the launch of capital increases worth a combined $741 million by EFG-Hermes and Orascom Construction Industries during February 2006, which caused investors to liquidate stocks in an attempt to raise funds for the new offerings. Criticism of the lack of transparency governing public company offerings, the presence of senior politicians on boards of directors of fund management firms and price manipulations have also been cited as causes behind the recent instability. In April 2006, in an attempt to shore up inexperienced dealers, and possibly to induce brokerages to merge, the Chairman of the CASE announced new capital adequacy rules for brokerage firms wishing to be members on the stock exchange, including a minimum £E 5 million as capital (up from £E 250 thousand). Also in April 2006, Decree No. 141 for 2006 was issued prohibiting the manipulation of prices and exploitation of internal stock exchange information.

The CASE continues to work to bring the market closer to international standards. As of January 2007, companies listed on the CASE are required to comply with a code of Egyptian Accounting Standards compatible with International Financial Reporting Standards (IFRS) and a code of corporate governance drawn up by the Institute of Directors, affiliated to the Ministry of Investment, in collaboration with the International Finance Corporation. The number of listed companies has continued to drop with the tightening of performance standards and disclosure requirements, 1151 in December 2002 to 595 companies in December 2006. The removal of tax exemptions on paid-in capital of listed companies under the new Income Tax Law has also caused voluntary delisting.

The stock market authorities are keen to further deepen the market and its trading options. Since 2005, legislative regulations have been put in place introducing new trading tools such as margin trading and short selling. However, the minimal use of these options, given the risks involved, implies that the market is not ready for such sophistication. This is due in part to the large base of amateur individual investors, which grew from 300,000 to 1.7 million between January and October 2006. Retail investors dominate about two-thirds of the market's activity. After the February 2006 crash, investors protested that newly introduced intraday trading was the cause. CASE is now running public awareness campaigns to educate the public about the market. Nonetheless, the CMA has publicly stated its intention to attract more corporate investors and increase their share in the market to 50% of total market activity. In July 2006, the CMA issued a new rule stating that short selling is to be applied only on intraday trading of stocks, in order to overcome technical deficiencies at the central registry which does not transfer title at the time of the transaction.

In April 2006, the Dow Jones Index teamed up with the CASE to launch the Dow Jones CASE Egypt Titans 20 Index. This index is designed to serve as an underlying marker for investment products such as mutual funds, exchange-traded funds and other financial products that enable investors to participate in the performance of the Egyptian stock market. In May 2006, the CMA issued Decree No. 50/2006, organizing online trading on the stock exchange. The decree opened the door to brokerages to receive requests for buying and selling shares by clients, via the Internet. It is noteworthy that the decree is limited to online purchase/selling requests of securities, and does not address transaction settlements or transfer/collection of dividends via the Internet. Market insiders believe extending the online facility to these areas is currently not feasible, given that online banking in Egypt still requires much development. Only two companies have received Internet-trading licenses to date.

The CASE has also revealed plans to establish a stock exchange for SMEs with its own listing requirements and supervisory environment in the latter half of 2007. Plans for a commodities exchange are also underway. CASE authorities have not yet indicated whether it will be limited to cotton or will include other crops.

In May 2002, the Minister of Finance issued Decree Number 480, authorizing the establishment of a primary dealers system for government securities. The system, which began operating in July 2004, allows 15 financial institutions listed with the Ministry of Finance, including banks and bond dealers, to underwrite primary issues of government securities and activate trading in the secondary market through sale, purchase, and repurchase agreements of government securities based on a multiple-price auction system. In FY 05/06, 112 auctions were conducted (with a total value of ₤E 135.7 billion, of which 2 auctions were bond issuances in the sum of ₤E 4 billion, and the remainder treasury bills). In the first three quarters of FY 06/07, 102 auctions were held, for a total of ₤E 117.8 billion, including 1 bond issuance worth ₤E 2 billion. Interest rates on the three maturities of treasury bills (91, 182 and 364-days), rose to 9.2-9.6% in January 2007, after declining from 10.4-10.6% to 8.7-8.8% between FY 04/05 and FY

05/06. While the number and value of auctions is a fraction of government debt, it is still a positive indicator of lower off-balance sheet borrowing from the CBE for deficit financing purposes, and a relatively better-structured debt market.

Insurance: Egypt's insurance industry remains very small relative to other middle-income developing countries, with annual premiums accounting for only about 0.8% of GDP. The government reported total insurance sector assets of £E 22.3 at the end of FY 05/06 and £E 20.1 billion in FY 04/05, an increase of 10.9%. Premium income was £E 4.8 billion in FY 05/06, up 7.3% over FY 04/05. Non-life insurance amounted to £E 3.1 billion in FY 05/06, up from £E 3 billion in FY 04/05. Life insurance services continue to outperform non-life insurance, with premia increasing to £E 1.8 billion in FY 05/06 from £E 1.5 million in the previous year, for a growth rate of 17.5%. Each company must continue to reinsure 10% of non-life policies and 50% of life insurance policies with state-owned Egypt Reinsurance.

Four state-owned insurance and re-insurance companies continue to dominate with over 70% of the market. There are currently seventeen private companies in the market, with three providing all classes of insurance; seven offering property and liability insurance policies and five transacting life insurance. The Export Credit Guarantee Company provides insurance to exporters and importers while the Cooperatives Insurance Society for Small Enterprises services covers small businesses. The penetration rate of foreign firms in the sector remains low.

While insurance operations welcomed 2006 stamp duty reductions on insurance premia, further reforms are needed, including activating the role of intermediaries, introducing bancassurance (the sale of insurance by banks), strengthening the role of the regulator, raising skilled staff and privatizing state-owned firms. These and other reforms, should prompt substantial growth and foreign investment. The Ministry of Investment announced in 2005 that an international consortium would restructure its four state-owned insurance companies, opening the way for privatization. The ministry selected the Paris-based BNP-Paribas, Egypt's CIB, and the New York-based insurance consultancy firm Milliman. Once restructuring is complete, a privatization plan for at least one of the companies will be devised. The consortium delivered a diagnostic report in December 2006; a valuation and restructuring report is expected to by mid-2007. The report is expected to run scenarios for optimal capital utilization and provide an outlook for privatization, whether full, partial or segmented.

In August 2006, a presidential decree established a Holding Company for Insurance, under the Public Enterprise Sector Law, covering public insurance and reinsurance companies. The new company is expected to facilitate the restructuring process of the public insurance companies and possible privatization once restructuring is complete.

Other Financial Services: The previously stagnant mortgage market is slowly progressing in terms of underlying regulations and the number of active players in the market. According to the Mortgage Finance Authority (MFA), mortgage credit extended has risen from £E 15.8 million in September 2005 to £E 1 billion in December 2006.

About £E 300 million of the latter figure was issued by mortgage credit companies and the rest by commercial banks. These figures are in sharp contrast to zero mortgage credit prior to 2004. Nevertheless, mortgage credit has not increased enough to solve Egypt's housing problems, particularly for low income earners, among whom demand is strong but financing is unavailable. Mortgage finance as currently structured involves at least 10-year credit in addition to sufficient collateral. Several banks are providing seven to ten year housing loans.

The Nazif Cabinet stepped up efforts in 2006 to address various structural problems hindering development of a mortgage credit system. Difficulties included cumbersome registration procedures, lack of professional know-how, and high financing costs. In 2005, the executive charter of the Mortgage Law was amended to allow banks to assess clients' creditworthiness based on monthly salaries. Infrastructure issues were also tackled by the MFA. Over 80 appraisers have been certified by the MFA and can now conduct approved appraisals. The MFA board is developing a project for re-organizing the appraiser profession to rank appraisers in a manner that conforms to market variables and international standards.

To address Egypt's complicated registration procedures, a new property title registration system is under development. A pilot project to develop national land title registration is underway in nine zones, mainly new urban communities. A tender was organized in September 2006 for IT systems to service the registration process. These systems should be operational by mid-2008. In parallel, the Ministry of State for Administrative Development and the Ministry of Justice are working to strengthen the process of deeds registration, by streamlining procedures and developing a public awareness campaign in one model location, central Cairo's Mokattam district. These procedures will then spread in the future to other urban areas. The registration system is expected to be fully functional throughout the country by 2013. Unlike urban registration, title registration for agricultural lands is well established.

The MFA has also lowered registration costs. A May 2006 law brought registration fees down to a flat rate, irrespective of the contract value of the property. In August 2006, the Ministry of Investment issued the new schedule of property registration fees as follows: £E 500 for areas up to 100 sq. meters, £E 1000 for up to 200 sq. meters, £E 1500 for up to 300 sq. meters and £E 3000 for areas over 300 sq. meters. Costs are still considered high for the average Egyptian family.

Little has been done to address land ownership certification. Long-awaited legislative amendments addressing this issue are still pending. Ownership transfer is usually not registered, due to cumbersome registration procedures and high costs, and a lack of public awareness.

The CBE is also addressing credit access problems by permitting banks to lend at least 5% of their loan portfolio as real estate finance. To date only two mortgage companies are operating; two more have been licensed by MFA. Orascom Hotels and Development owns one of the companies – Tamweel, established in 2006. Tamweel will target mid-and high-income borrowers with a minimum mortgage rate of £E 100,000. According to the mortgage law, Tamweel must increase its paid-in capital from the current £E 12.5 million to £E 50 million within one year. In September 2006, the Chairman of the MFA announced the establishment of a fourth mortgage finance company, backed by Amlak of the UAE, with licensed capital of £E 500 million and issued capital of £E 50 million. Stepped-up mortgage activity makes the need for functioning credit bureaus that much more urgent. Well-functioning credit bureaus will help companies assess potential clients' creditworthiness, and make it possible for lenders to adjust interest rates according to risk.

Developments at the secondary market level for mortgages over the past year include a small number of securitization issues – the first since the introduction of securitization regulations into the Capital Market Law in 2004. In May 2006, the CMA gave approval for the Real Estate Bank to issue 7-year securitization bonds worth £E 500 million, with a face value of £E 1000 for public subscription. In June 2006, the MFA established the Egyptian Liquidity Facility (ELF), or the Egyptian Company for Mortgage Refinancing, to play the role of market-maker by re-financing the portfolios of banks and companies involved in the mortgage industry with interest rates lower than the prevailing market rates. The facility was created by the CBE and 24 public and private financial institutions, with an initial capital of $35 million. The World Bank provided a $37.1 million start-up loan and technical assistance. The ELF will also perform securitization for primary mortgage financing institutions. In August 2006, the stock exchange listed securitization bonds issued by Contact Company for Securitization, for a value of £E 140 million with a fixed annual return of 11%. The AA-graded bonds have a 5-year maturity, and were issued against a securitization portfolio of £E 176 million.

The high-end residential, commercial and tourism real estate are booming, triggered by investment from the Gulf, outflows from the stock market during its vulnerable phases and reduced restrictions on foreign property ownership in a number of tourist areas, namely the Red Sea, Hurghada, Sidi Abdel-Rahman and Ras Al-Hekma in Matrouh Governorate. However, there is a persistent backlog in demand for housing units by the middle and lower middle-classes, and new demand each year for 300,000 - 350,000 new housing units in line with Egypt's fast-growing population. It will likely take several years for the market to incorporate and bring mortgage finance within reach of a majority of home seekers.

Energy: The gas sector continues to be among the brightest spots in the economy, not only in terms of gas exploration, development, and production but also in terms of gas exports, which have increased significantly since 2005. Oil production and exports, while declining, still play an important role in the economy. In FY 05/06 the oil and gas sector was 12% of GDP and more than one-third of annual merchandise exports. In the first half of FY 06/07, oil and gas export earnings were $4.8 billion, a 75% increase over the previous year. The oil and gas sector continues to account for the bulk of FDI in Egypt, with participation from industry giants such as British Gas (BG), British Petroleum (BP), Italy's ENI, and Shell, as well as leading independent producers such as U.S.-based Apache. Other U.S.-based exploration, drilling, and oilfield services companies also work in Egypt, and this sector continues to present some of the country's best trade and investment opportunities.

Crude oil production has been declining for more than a decade, from more than 920,000 barrels per day (BPD) in 1995 to an average of 640,000 BPD in 2006. Proven crude oil reserves declined from about 4 billion barrels in the early 1980s to less than 3 billion in 2001, but have stabilized since then because of recent discoveries and technological advancements. At the end of 2005, proven and probable reserves, including condensates, were estimated at 3.7 billion barrels. Meanwhile, domestic consumption of petroleum products grew about 1% annually over the last two years, squeezing the available surplus of Egypt's largest single merchandise export. Domestic consumption had held steady since 2000 at around 550,000 BPD, but with the economic pickup since late 2004, rose to an average of 616,000 BPD in 2006.

Gas and gas condensates production and reserves continue to rise. Over the last five years, natural gas production gas has increased by an average of more than 14%, reaching more than 5.6 billion cubic feet (BCF) per day by the end of 2006. Approximately 1.6 BCF per day is exported. During the same period, production of gas condensates doubled to approximately 110,000 (BPD), partially offsetting the decline in daily crude oil production. By the end of January 2007, proven reserves had almost tripled over the past ten years to more than 69.5 trillion cubic feet (TCF). The government estimates probable reserves at another 40-80 TCF, but other industry sources are less confident of this figure. Gas continued to account for slightly less than 50% of all hydrocarbon usage in Egypt in 2006. Most natural gas consumed in Egypt went to generate electricity; more than 60% of Egypt's total gas consumption was used by Egypt's 28 electrical power stations, feeding more than 90% of those stations' fuel needs. The remaining gas was used by about 500 industrial factories, more than 55,000 compressed natural gas vehicles, over 2 million residents, and about 13,000 commercial customers.

The government conducted several rounds of new concession awards over the last four years, and as of August 2006 had signed more than 77 oil/gas exploration agreements with combined investments worth $2.5 billion. The agreements included several foreign companies such as BP, BG, Apache, Malaysia's Petronas, ENI's subsidiary IEOC, and Shell. The international bid round of the Egyptian General Petroleum Corporation (EGPC) in 2005 resulted in the awarding of nine exploration blocks, for which finalization and legal review of official agreements are underway. EGPC announced on August 10, 2006 that six additional blocks would be awarded. The submitted offers are currently under evaluation. The Egyptian Natural Gas Holding Company (EGAS) announced in January 2006 an international bid round for 2006 in which twelve blocks in the Mediterranean Sea, north Sinai and the Nile Delta would be available. Nine of the twelve are currently up and running. The newly established Ganoub El Wadi (the Egyptian South Valley) Holding Company announced an international bid round in February 2006 that included eight blocks in the south of the Western Desert and Red Sea, five of which have been awarded. Despite the number of international exploration bid round announcements over the past two years, some industry observers have expressed concerns about the slow, bureaucratic pace of final approvals on agreements. Currently, Egypt has about 80 exploration and production operators, about half of which are foreign firms and the rest either joint-ventures or entirely Egyptian.

Texas-based Apache Corporation is the largest acreage holder and the most active driller in the Western Desert of Egypt. It holds over 7.5 million net acres in 18 separate concessions, including five new concessions and four exploration period extensions on existing concessions approved by Parliament in 2005. It spent $700 million in oil/gas operations in 2006 and is planning to spend about $1 billion in 2007 for a total investment in Egypt of about $5.4 billion. Last year, Apache acquired a record 1.5 million acres (6,332 square kilometers) of 3-D seismic data. Analysis of the data has identified exploration well locations in several concessions in the north of the Western Desert. These are Matrouh, Ras Kanayes, West Kanayes, North Tarek, Shushan, El Diyur, East Bahariya, Northeast Abu Gharadig and East Ras Budran concessions. Apache has 3-D seismic coverage over more than half of its 10.2 million concession acres in Egypt.

The Qasr Jurassic oil and gas field discovery in the Western Desert is Apache's largest discovery, with gross proven reserves of 2 trillion cubic feet (TCF) of gas and 65 million barrels of condensate. As of January 2007, it recorded a gross production of 325 million cubic feet (MCF) of gas and 16,000 barrels of condensate per day from eight wells. Since production started in July 2005, Qasr has produced a total of 115 BCF of gas and 6.3 million barrels of condensate. Gas production from the field will increase with the construction of two new gas plants, each with a capacity of 100 MCF per day, scheduled for completion by the end of 2008. The Qasr field also produces 7,450 barrels of oil per day from 10 wells with a cumulative oil production until January 2007 totaling 5.8 million barrels of oil.

Apache also continued aggressive development of the Yomna, Asala Ridge and El Diyur-North El Diyur oil field discoveries drilled in the Qarun area in 2005. The Yomna field commenced water injection during the fourth quarter of 2006; current field production is 3,200 barrels of oil per day. Asala Ridge production has increased to 5,600 barrels of oil per day, the use of water injection since last December should further aid future production. El Diyur-North El Diyur currently produces 2,900 barrels of oil per day. Apache has an aggressive exploration and development drilling plan in 2007 with a total of 268 wells, including 33 new field wildcats, compared with 156 wells, including 15 new-field wildcats, drilled in 2006.

In January 2007, the government announced some new oil and gas discoveries in the Gulf of Suez, the Eastern and Western Deserts and the Mediterranean. According to government reports, these will likely add about 140 million barrels of crude oil and condensates and 1.5 TCF of natural gas to Egypt's hydrocarbon reserves. Among these discoveries are: Al Karam (1) & (2) in the Western Desert by the Greek Company Vegas, and Sidi Rahman-1 in the El Alamein area by the Croatian oil company INA-Nefta with an expected production of 3,200 barrels per day of high quality crude of API49 and with probable reserves of about 30 million barrels. In addition, Shell Egypt made two new oil and gas discoveries in the Western Desert, which will increase the company’s daily production capacity by an additional 42 MCF per day of natural gas and 4,000 barrels per day of oil. In January 2007, British Petroleum (BP) announced the successful drilling of the Giza North-1 well in the off-shore North Alexandria concession jointly held by BP, RWE Dea UK (a subsidiary of German E&P company) and EGPC/EGAS. The well struck a gas accumulation with an estimated reserve of about 1 TCF of gas. The drilling of another well in April 2007 will allow further appraisal the field as part of a four-well appraisal program in the North Alexandria concession.

Gas is now one of Egypt's large merchandise exports. Exports come chiefly from two main LNG plants, in Damietta on the Eastern Delta and Idku in the west of the Nile Delta, and through a pipeline connection with Jordan. Exports from the two LNG facilities at Idku and Damietta have made Egypt the sixth-largest LNG exporter in the world, behind Indonesia, Qatar, Malaysia, Algeria and Nigeria. The first LNG shipment from Egypt to the U.S. left Damietta in March 2005. This LNG plant is operated by the Spanish-Egyptian Gas Company (SEGAS), a joint venture in which Spain's Union Fenosa Gas is the main investor and is joined by Italy's ENI, and Egypt's EGAS/EGPC. The total 5.5 million tons per year liquefaction and export capacity of the plant has already been sold for the next 23 years. Union Fenosa, the main investor in SEGAS, has already guaranteed to sell 3.2 million tons per year for the next 23 years. EGAS signed a "tolling agreement" with SEGAS in 2003, under which EGAS will guarantee to sell the remaining 2.3 million tons per year of spare capacity.

EGAS has a five-year agreement with BG Group to supply gas to the Damietta site from the Scarab Saffron Fields in the West Delta Deep Marine (WDDM) concession offshore of the Nile Delta. The five-year contract was arranged between BG Group and its partners including Malaysia's Petronas. Under the terms of the agreement, BG Group will supply 225 MCF per day for the first four years and then 150 MCF per day in the final year. In addition, BP Egypt has signed an agreement with EGPC and EGAS to supply up to 310 MCF per day of natural gas to the plant starting from 2008.

SEGAS is considering plans for a second train after securing a joint off-take and feedstock agreement for the first train with Union Fenosa. In June 2006, Union Fenosa signed a framework agreement as part of a joint venture to double its $1.3 billion in Damietta LNG output with a second production plant. The second train will become operational by 2011 and will have a capacity of max 7 BCM per year, bringing the total output from Damietta to 14 BCM per year, or slightly less than half of Spain's total gas demand

As for the Idku LNG plant, BG, Petronas and Gaz de France are the principal owners in conjunction with a smaller share from the Egyptian government. The facility has an annual production capacity of 10 BCF. The majority of exports go to France, Italy and the U.S. The plant has two LNG trains. The first LNG train came on line in 2005. Exports of 3.2 BCM per year will also be shipped beginning in 2008 from the Idku facility to the Brindisi LNG terminal in southern Italy, under the terms of an agreement between BG and the Italian electricity company ENEL. Until these exports begin, the exports from the Idku facility will be supplied primarily to the Lake Charles LNG terminal in Louisiana, USA. Exports from Idku's second train, purchased by BG, began in 2005.

The second phase of the Arab Gas Pipeline was completed in 2005, running from Aqaba in southern Jordan to the Rehab El-Shamal region north of Jordan (29 kms from the Jordanian-Syrian borders, i.e., a total of 395 km), and was constructed at a cost of $300 million by the al-Fajr Company, a joint Egyptian-Jordanian venture. The Arab Gas Pipeline can carry about 10 BCM of Egyptian gas per year. The third phase of the project will extend the gas pipeline to enter Southern Turkey in Kilis from the Syrian borders. The length of the pipeline of that phase is expected to be about 240 km, starting from the north of Jordan to Syria and then to Turkey. Construction is ongoing, with the completion of the Syrian phase projected for sometime in 2007 – 2008.

In 2005 the governments of Israel and Egypt signed a memorandum of understanding (MOU) that could clear the way for a long-awaited $2.5 billion commercial gas deal between Eastern Mediterranean Gas (EMG) and the Israeli state-owned Electrical Company. While the technical details of the commercial deal are not known, 25 BCM of Egyptian natural gas will be exported over the coming fifteen years (an average of 1.7 BCM of gas per year) through an extension of the existing gas pipeline from the Egyptian port of El Arish to Ashkalon, Israel. The MOU provides a "political umbrella" for the commercial agreement. Under the MOU, the Egyptian government commits to providing Egyptian gas to commercial companies (in the present case it is EMG) to then export it commercially to Israel. The Israeli government commits to provide tax incentives and exemptions for equipment and materials to be used for transporting the gas. During the summer of 2006, EMG reportedly resumed talks with additional Israeli customers who expressed interest in purchasing natural gas on the basis of 2006 market prices. By the second half of December 2006, reports indicated the possible conclusion of a $2 billion contract for the import of Egyptian natural gas from EMG, for a period of 15 years with a possible 5 year extension by the year 2008 when the EMG pipeline is completed. However, nothing is confirmed about these negotiations.

As another way of utilizing its gas reserves for both exports and domestic consumption, the government-owned Egyptian Petrochemicals Holding Company (ECHEM) was established in 2002 to develop the petrochemical industry. ECHEM's twenty-year plan envisions the establishment of up to 14 petrochemical plants on Egypt's coastline to produce propylene, linear alkyl benzene (LAB), and end-use consumer items. In 2004, the Egyptian Linear Alkyl Benzene Company awarded a contract to the U.S.-based Fluor Corporation to manage development of a new facility in Alexandria for the production of linear alkyl benzene, which is principally used in detergents. The facility is expected to be operational in late 2007 or early 2008. In February 2007, an agreement was signed between the Egyptian private group Oriental Weavers and the German company ODA for the construction of a new plant to produce about 400,000 tons of propylene and polypropylene at El Gamil Industrial Zone in Port Said. Total investment in the project is $680 million, and 65% of the production will be directed toward exports. Production is expected to start by the last quarter of 2009. The main investors in this project are

Oriental Weavers (26%), GASCO and the government petroleum sector (26%), and other non-disclosed Arab investors.

Despite booming gas exports, questions persist about the future. There is considerable variance in estimates of probable gas reserves and some industry observers question whether Egypt's gas production will grow fast enough to keep up with planned export sales, development of the petrochemicals industry, and growing domestic demand for natural gas which is being sold in Egypt at heavily subsidized prices. In October 2005 the government announced that it would only allocate one-quarter of proven reserves for export, rather than one-third as originally planned. Moreover, in March 2007, the Minister of Petroleum said the Ministry would postpone implementation of new export projects until the government can assure the supply of natural gas to new proposed domestic industrial projects. The ministry has a number of proposals for new industrial projects in Egypt that heavily depend on energy. The proposals include establishment of 29 new cement factories, 9 fertilizer projects, 2 aluminum complexes and four new units for iron and steel.

Egypt's domestic gas pricing policy impacts gas supply, as the government provides gas at subsidized prices to power plants, which in turn provide low cost power to industrial and domestic consumers. In December 2006, the Minister of Petroleum asked parliament to lobby the High Constitutional Court to reverse its 1997 decision prohibiting multi-pricing of gasoline and natural gas in the domestic market. The minister argued that since demand for investment in Egypt has become stronger, especially in the cement, fertilizer and steel manufacturing sectors, the ministry should be selling energy at higher prices to factories, while maintaining the subsidized price for the general public. Recent studies indicated that out of a total £E 100 billion government budget subsidy allocation in FY 06/07, £E 53 billion goes to energy subsidies. The effects of subsidized energy in boosting consumption and thwarting conservation are well documented, and Egypt's policies have resulted in inefficient use of energy resources by the general public and the industrial sector.

In February 2007, the Minister of Trade and Industry imposed export fees on steel and cement commodities (160 £E per ton for steel and 65 £E per ton for cement). By doing so, the minister hoped to balance the recent sharp rise in the price of these commodities in the domestic market due to the producing companies' preference to seek high export profit margins rather than supply domestic demand. It remains to be seen if the decree will cause investors who had been intent on building new factories for steel and cement to rethink their business plans, particularly after the government announced plans to liberalize energy prices for industrial establishments within the next 5 to 10 years.

On July 21, 2006 the government increased domestic prices of some petroleum products such as gasoline (octane 90) to 130 piasters (pts) per liter from 100 pts; diesel fuel (Solar) to 75 pts per liter from 60 pts; Mazout (fuel oil) to 500 £E per ton from 300 per ton; and kerosene to 70 pts per liter from 40 pts per liter. The price increase for 90 octane gasoline was the first such increase in 14 years. Reports indicated that this price increase will lead to an overall annual savings of £E 3.5 billion ($ 608 million) in government spending in subsidies. However, the cost of explicit and implicit subsidies grows as Egypt's domestic consumption of oil and gas increases -- despite the above mentioned savings. The cost of government subsidies in 2006 reached £E 42 billion and is expected to increase even more in 2007.

Currently, electrical consumption in Egypt is divided between home use (37%), industry (36%), and commercial and public lighting and facilities (27%). This past year, Egypt's electricity consumption has grown 10.2% and the state subsidy of the domestic consumption of electricity amounts to more than £E 3 billion per year. To meet that demand, the government's long-term plan called for the construction of up to 17 new steam and/or combined-cycle power plants between 2003 and 2012 (i.e., over the course of the government's two 5-year plans for 2002-07 and 2007-12). These plants would add an additional 12,875 megawatts (MW) of generating capacity, almost doubling Egypt's current capacity. Four of these power plants are now in operation (Cairo North 1&2 and El Nubariya 1&2). Financing and tendering for an additional two 750 MW plants at Talkha and Kureimat are completed and the plants are expected to be in operation by 2007. Financing for the ongoing and future projects is coming from international financial institutions (chiefly from the European Investment Bank (EIB) and Arab Fund for Economic and Social Development, and Kuwait Fund for Arab Economic Development) and bilateral credit guarantee agencies (the U.S. Export-Import Bank is financing the Nubariya turbines being produced by General Electric).

In 2006, the Ministry of Electricity and Energy announced that Arab and international financing has been secured for 90% of the projected electricity projects targeted in the coming 5–year plan (2007-2012). In April 2006, the EIB agreed to support the coming 5-year electrical production plan (2007/2012), which aims to add 7,857 MW to the national grid. EIB has already provided € 650 million to support a 4,500 MW expansion of the national grid, completion of which is expected by mid 2007. In November 2006, the Ministry of Electricity and Energy began a project to modernize the High Dam Electricity Station with a $580 million German Reconstruction Bank loan.

Speaking at the National Democratic Party's annual party conference on September 21, 2006, President Mubarak, echoing statements made by his son Gamal two days prior, announced Egypt's desire to explore nuclear energy as an alternative to its continued reliance on fossil fuels. Shortly thereafter, Prime Minister Nazif convened the Supreme Council for Energy for the first time in 18 years to discuss the way forward in assessing the potential for nuclear energy development. Soon after the President Mubarak's speech, the U.S. government announced its willingness to work with Egypt in the development of safe, proliferation-resistant nuclear energy under the frame work of the Global Nuclear Energy Partnership (GNEP).

The Minister of Electricity and Energy Hassan Younis is currently working with international consultants and the Ministry of Petroleum to conduct a comprehensive energy needs assessment that would lay out the case for whether or not Egypt should pursue nuclear energy. Egypt abandoned earlier efforts at nuclear power development following the Chernobyl disaster in 1986. While Egypt has refrained from fully committing to the nuclear project pending completion of the energy assessment, many analysts believe that the studies will argue for peaceful nuclear development given Egypt's rapidly increasing energy consumption and other priority uses for Egypt's gas and oil reserves. Additional studies are underway regarding the location of the proposed power plants, in addition to studies regarding the optimal sizes and number of plants. The Minister of Electricity and Energy announced that Egypt will seek international partners in its overall effort and, in addition to the U.S., France, Germany, Russia, Canada, Australia, China, and South Korea, and others have expressed willingness to work with Egypt in nuclear power development. In March 2007, press reports indicated that the World Bank was open to exploring options for financing peaceful nuclear energy projects in Egypt.

Construction: The construction and building-materials industries continued to grow on buoyant export demand in 2006. Government figures put cement production at 36.2 million metric tons (mmt) for FY 05/06, an 8% increase the same period in FY 04/05. High international prices pushed up profitability of Egyptian cement and steel producers. On the negative side, higher international prices also pushed up domestic prices, precluding a healthy rebound in domestic demand for building materials and prompting accusations of monopolist practices in the sector and price manipulation. By August 2006 domestic cement prices per ton averaged £E 380. In attempt to control prices, the Ministry of Trade and Industry asked producers to observe a voluntary price cap of between £E 295 and £E 302.5 per ton. Not all cement producers complied, although the major producers, including Sinai Cement, Qena Cement, Al Kawmia, Suez Tora and ASEC Cement, did. As these producers control approximately 67% of the market, by September 2006, prices had decreased to an average of £E 300 per ton.

Domestic steel prices also declined by nearly 10% in the last quarter of 2006, with prices dropping to between £E 2,980 to £E 3,500 per ton. This was due mainly to a slight drop in international oil prices, which affected prices of steel inputs such as iron, copper and aluminum. Government figures indicate that steel production was 3.0 mmt for 2006, a decrease of 1.7% from 3.2 mmt for 2005.

The early fourth quarter 2006 decline in cement and steel prices did not last long, as domestic prices of both commodities began creeping up in December. Cement prices were £E 334.8 per ton in December, and steel increased to £E 370 per ton in the same period. As noted in the Energy Section, in February 2007, the Minister of Trade and Industry imposed export duties of £E 65 per ton of cement and £E 160 per ton of steel. The decree also required steel and cement dealers and producers to inform the ministry's internal trade department of their production rates, stocks, export figures and prices on a regular basis. The ministry stated publicly that the export tariffs were aimed at controlling domestic prices and recouping the government's energy subsidy to industry. The export fees had the intended effect, as within two weeks prices dropped £E 300 to £E 400 per ton, and cement prices dropped by £E15 per ton. The average price of cement is expected to remain at £E 340 per ton during the 2007 summer high season for the cement market.

Manufacturing: During 2006, the manufacturing industry benefited from the economic reforms, which brought about lower input prices and reduced red tape. According to government statistics, Egypt's manufacturing sector accounts for approximately 20% of GDP and 14% of employment. Food processing and textile products account for the bulk of Egypt's manufacturing, while other main sub-sectors include metallurgy, fertilizers, and other consumer goods.

<u>Automotive:</u> Completely Built-Up (CBU) cars, imported from Europe, Japan, South Korean, Turkey, the U.S., China and Gulf countries, make up 58.8% of the automotive sales market, with the remaining 41.2% comprised of locally assembled cars. Nine different companies assemble vehicles in Egypt. The still-fragmented production base offers few economies of scale and Egypt has developed only limited feeder industries for vehicle parts.

Two years after the 2004 tariff cuts, the automotive industry is reporting record sales. Passenger cars sales jumped to 132,373 cars in 2006 from 94,538 cars in 2005, a 32.8% increase, while commercial vehicle sales grew by 30.9%. The passenger car segment was more vulnerable to interest rate rises, while the commercial vehicle segment benefited from growth in both domestic and international trade. According to the Egyptian Chamber of Automotive Feeding Industries, total market volume sales (passenger cars, buses and trucks) for 2006 was higher than 2005 by 40.5%, increasing from 121,437 to 170,614 units.

The tariff reductions introduced in January 2007, which slashed duties on 1,114 products, did not change duties on imported or locally assembled cars. For imported cars with engine sizes of 1,000 to 1,600 cubic centimeters (cc), tariffs are still 40%. For cars larger than 1600 cc, the tariff remains at 135%. Additionally, tariffs on trucks remain at 40%. The new tariff structure set duties on automotive inputs and spare parts at between 5 and 12%, down from 23 and 33%. In accordance with the Egypt-EU Association Agreement Egyptian automobile manufacturers will begin facing lower tariffs on automobiles imported from EU member nations in 2010. From that year until 2019, tariffs will be reduced 10% annually.

New executive regulations for the 2005 Export and Import Law lifted the restriction that imported cars must be from the country of origin. As the industry remains largely import-dependent, this decision is the likely cause of the rise in imported cars at the expense of locally assembled ones, especially with the declining exchange rate.

<u>Textiles:</u> The Egyptian textile industry is the second largest industry in the country (after food processing). It employs approximately one million people, about 30% of the industrial workforce. It generates 27% of industrial production and 11% of manufacturing GDP and contributes about 25% of non-oil exports. Government figures report a growth in exports of textiles and ready-made clothes from $734 million in 2005 to $802 million in 2006, in part due to the overall economic upturn.

The export figures encompass both new, business-savvy, well-equipped, and export-oriented firms (mostly private ones in the clothing industry) and older, unprofitable, largely state-owned firms employing outdated equipment and excessive workforces, particularly in the spinning and weaving sub-sectors. The government has introduced some changes in management of state-owned companies, and announced plans to privatize some firms. It is also implementing a long-term strategy to restructure the entire industry with the aim of increasing competitiveness by 10% per year. The EU will fund this plan through 2025, though the main driving force will be the Egyptian private sector. In February 2007, tariffs were reduced for certain inputs for textile and apparel production. Tariffs on fabrics dropped from 22% to 10%, on threads from 12% to 5%, on garments from 40% to 30% and on yarn from 12% to 5%.

Plans for restructuring the textile sector have resulted in some worker strikes and protests. A wave of strikes spread through Delta textile factories in late 2006, as workers demanded higher wages, amid fears that the management changes introduced by the government, and potential privatizations, would cost them their livelihoods. Largely due to these labor protests, the Ministry of Investment has taken a much more cautious approach toward announcing plans for privatizations in the first few months of 2007.

The Qualifying Industrial Zones (QIZ) program with Israel, which took effect December 14, 2004, grants Egyptian manufacturers within the QIZs duty free access to the U.S. market under the U.S.-Israeli Free Trade Agreement, provided that their exports contain at least 35% local content, including at least 11.7% Israeli content. The U.S. Trade Representative (USTR) initially designated seven QIZs: Port Said Industrial City, 10th Ramadan Industrial City, Shobra El Khaimah, 15th of May Industrial City, Nasr City, South of Giza, and El Amria/Borg El Arab in Alexandria. In 2005, the U.S. government approved the Egyptian government's request to expand by adding four industrial areas in the Cairo region – Obour City, Badr City, 6th October City, and Qalyoub – and two industrial areas in the Suez Canal region – Ismailia and Suez City.

By the end of September 2006, 638 companies qualified to export under the QIZ program. Although the QIZ benefit applies to products in a variety of sectors, the 138 companies now exporting under the program are all apparel or textile manufacturers. By the 4th quarter of December 2006, apparel exports to the U.S. increased by 60%, to reach \$176.7 million, compared to \$110.5 million during the same period in 2005.

The QIZ arrangement has also contributed to increases in FDI in the zones, which totaled \$63.3 million between January and October 2006. Indian, Turkish and Taiwanese companies all invested in the textile and apparel sector in 2006, capitalizing on the country's lower operating costs and favorable export opportunities. Egypt's FTA with Turkey, which came into effect March 1, 2007, is expected to significantly increase growth and development in the textile sector, adding to Egypt's competitiveness.

U.S. tariffs on textile imports will eventually be eliminated under WTO commitments and the QIZ benefit will essentially evaporate, making increased competitiveness essential to the survival of Egypt's textile industry. To improve competitiveness, attention is needed to challenges such as quality control and improved design as well as upstream industries. The greatest challenge, however, remains overstaffing and costly payrolls and pensions. The Nazif administration has yet to develop a consistent, effective policy for workforce downsizing.

Pharmaceuticals: The Ministry of Health and Population caps sales prices for pharmaceutical products, hampering the sector's development, although the ministry has selectively raised some prices. Because both domestic and foreign pharmaceutical companies rely heavily on imported inputs, profitability dropped sharply with the depreciation of the Pound in 2003, and some companies claim to be operating at a loss. Some companies have cut back their operations, including halting production of certain medicines.

In February 2007, customs duties were reduced for some pharmaceutical inputs and products from 5 to 2% and for others from 2% to zero. The government claimed this would compensate local pharmaceutical companies for some of their losses. Although local companies, which produce mainly off-patent, generic products, are not suffering as much as foreign firms, price controls reduce their profitability and limit their ability to sustain and expand production.

To promote growth of the pharmaceutical industry, the current policy of subsidizing drug prices for all consumers will have to change to cost-based pricing with subsidies aimed at the truly needy. The government must also address problems related to intellectual property rights (IPR) protection, particularly the lack of adequate protection against unfair commercial use of data generated to obtain marketing approval for drugs. In its annual review of foreign country IPR compliance, the U.S. government cited this particular problem as part of its basis for maintaining Egypt on the "Priority Watch List," where it has been since 2004.

IPR protection in Egypt should improve as a result of some important recent developments. For instance, in March 2007, the patent office issued its first pharmaceutical product patent since it began examining "mailbox" applications in January 2005. Also, the Ministry of Health issued Decree No. 370 for 2006, effective January 1, 2007, which reduces the registration procedures timeline to 120 days for products that have already been approved for marketing in the U.S., the EU, and by the World Health Organization. This is important since the data protection period in Egypt runs five years from the date the application for registration is received by ministry, instead of the date of approval. It is, however, too early to tell for certain whether the ministry will be able to implement the new streamlined approval system and issue approvals within the allotted 120 day period. Local manufacturers also opposed the decision on the grounds that it favors multinational companies and allows them a longer IPR protection period for their products.

Egypt still remains on the USTR "Priority Watch List," which again cited Egypt's lack of transparency and deficiency in implementing IPR laws in the annual review of foreign country IPR compliance in 2006. The U.S. government is working with the Egyptian government to further IPR protection. With the assistance of USAID, the Egyptian IPR Contact Point, a dispute settlement body established by the Ministry of Trade and Industry in 2003, is reviving its role in solving IPR-related pharmaceutical issues. The office allows local and multinational pharmaceutical companies working in Egypt to meet and solve their cases before taking legal action.

Agriculture: Agriculture remains one of Egypt's most important sectors. Its growth rate in current prices increased from 6.3% in FY 04/05 to 8.6% in FY 05/06 and 9.8% in the first half of FY 06/07. Like most growing middle-income countries, however, agriculture's share of Egypt's GDP has fallen gradually from 20% in FY 86/87 to less than 14.5% in FY 05/06 and the first half of FY 06/07. Egyptians employed in agriculture have also fallen, from 33.8% of the labor force in FY 90/91 to an estimated 27.6% in FY 04/05. The challenge for Egypt remains maintaining and expanding agricultural production for domestic and export markets while concurrently adding value and employment through the development of more agriculture-based processing activities.

Egyptian wheat production was 8.18 million metric tons (mmt) in 2005, and increased somewhat to 8.27 mmt in 2006. Milled rice production was 4.14 mmt in 2005 and rose to 4.38 mmt in 2006. Despite these increases in production, Egypt remains one of the world's largest importers of wheat, a large food importer overall, and a traditional market for U.S. grain exports. U.S. exports dropped to about 17% of Egypt's 7.25- mmt wheat import market, in the market year (MY) 2004-2005, but when recovered to 26% of Egypt's 7.3- mmt import market in MY 05/06. U.S. market share is expected to remain stable or possibly decline, as private sector companies are now sourcing more wheat from less expensive suppliers such as Russia, Ukraine, and Hungary.

Cotton area and production in Egypt continue to decline, from 275,000 hectares and 932,000 bales in MY 2005-2006 to 248,000 hectares and 813,000 bales in MY 2006-2007. Cotton exports also dropped, from 438,000 bales in MY 2005-2006 to 380,000 bales in MY 2006-2007. Imports of short and medium staple cotton increased to 630,000 bales in MY 2006-2007 from 525,000 bales in MY 2005-2006. Higher prices for crops such as corn and rice cause farmers, particularly in Upper Egypt, to plant those crops rather than cotton. Horticultural exports, chiefly to Europe, remain a small percentage of total exports, though the sector has significant potential for expansion.

Reclamation and cultivation of desert land by private investors continues to grow, contributing to an increase in agricultural exports. According to the Chairman of the Agricultural Exports Council, agricultural exports for 2005-2006 are expected to reach $1.514 billion, up from $1.253 billion in 2004-2005. Export growth has been bolstered by reform efforts of the Minister of Trade and Industry to streamline the export process, particularly airfreight services and customs procedures. The government continues to place its expectations for future agricultural export growth in the full implementation of the EU Association Agreement and development of the Toshka agricultural scheme (see below). Food processing for both the domestic and export markets is an industry with still untapped growth potential, though new lower tax rates on imports of raw materials may create incentives for development of this sector.

The South Valley Development or "Toshka" project, located in Egypt's far south, aims to irrigate some 540,000 acres of arable arid soil with water from Lake Nasser. The project began in 1997, but construction slowed for several years. The main canal was completed in 2000, and two 28 kilometer branch canals were completed in 2003. Ninety percent of the third canal is now complete and about 25% of the fourth. Saudi Prince Walid bin Talal's Kingdom Agricultural Development Corporation (KADCO) owns 120,000 acres managed by the U.S. firm Cadiz/Sun World (which has a 10% investment stake in the KADCO project). KADCO's main aim is to grow fresh fruits and vegetables for export to Europe in the winter months. The Egyptian Holding Company for Trade has reclaimed 30,000 acres and will begin cultivation in the coming winter season. In March 2007, the Ministry of Agriculture signed an agreement with the Saudi group (El Raghi) for investment in a new reclamation project in Toshka that aims to reclaim 20,000 additional feddans in the Toshka area.

Information Technology and Telecommunications (ICT): Continued increases in mobile phone and computer penetration, combined with important legal and regulatory changes, have kept this sector at the forefront of market-oriented reforms in Egypt over the last three years. Industry estimates put the growth of the telecommunications sector at 20% annually, while a January 2007 assessment estimated that more than 6 million Egyptians (out of a total population of 79 million) use computers, with an increase of more than 150,000 new computers each month. The government also made significant progress in e-government services over the last two years. Nevertheless, use is still concentrated in the cities; more than 75% of the computers sold as of January 2007 were concentrated in Cairo and Alexandria.

The government reported that the number of dial-up users rose from 1.6 million in 2002 to about 6.4 million in January 2007, and projects that there will be more than 7 million Internet users by mid-2007. One reason for this rise is the cheap dial-up fee, currently less than one cent per minute. The government's “Broadband Initiative,” introduced in May 2004, cut the price of ADSL service from £E 150 ($24) per month for 256K transmissions to currently £E 95 ($16.70) and introduced wireless internet services for local and commercial business. According to official statements, ADSL subscribers have increased from 96,000 in January 2006 to more than 216,000 in January 2007.

The Ministry of Communications and Information Technology is partnering with other government bodies and the private sector to increase a still relatively low percentage of computer penetration (about 7.5%). Factors contributing to low penetration include insufficiently trained human resources, the absence of advanced Internet training in school curricula, low Arabic content on the net, and lack of public awareness. The ministry is sponsoring Internet centers and subsidized Internet cafes in towns throughout Egypt; as of January 2007, there were more than 1400 IT clubs, with plans to expand to 1500 by mid-2007. In October 2006, the Ministry of Communication and Information Technology and Ministry of Education contracted Lucent Technologies and its local business partner to improve Internet access and data delivery to some public schools. The trial project will provide broadband Internet access, e-mail, and distance learning at high speeds to students and educators. In December 2006, Google signed two agreements with the Ministries of Education and Higher Education, giving Google email, instant-messaging, and calendar web-based services to 3 million university and 8 million preparatory school students.

Mobile phone services continue to grow. As of April 2007, Egypt's two providers are Vodafone Egypt (majority owned by Vodafone) with a 48% market share, and MobiNil (owned by majority partner Orange Telecom and Egyptian minority partner Orascom Telecommunications) with a 52% market share. With the rapid increase in the number of mobile subscribers from 13.9 million in January 2006 to over 18.5 million in January 2007, both mobile operators negotiated with state-controlled Telecom Egypt (TE) to acquire its GSM 1800 frequencies to boost their existing GSM 900 frequencies. Currently, MobiNil and Vodafone Egypt are offering 2.5G (between 2nd and 3rd generation) services, such as WAP, GPRS, and SMS. However, over the last year public complaints about the quality of mobile services have increased. The National Telecommunications Regulatory Authority and Ministry of Communication and Information Technology have publicly threatened to take measures against the two operators if the quality of service continues to degrade.

In July 2006, backed by UAE-based ETISALAT, a consortium called Etisalat Egypt won a third mobile license for 2G/3G GSM service in July 2006 for a total of ₤E 17.6 billion ($3.1 billion), more than six times the government's minimum asking price. UAE ETISALAT holds around 66% of the equity, with the remainder split between the Egyptian Postal Authority, NBE, and CIB. Originally, full services were expected to start by April 2007, but in March 2007 the National Telecommunications Regulatory Agency granted Etisalat Egypt a postponement until May 21. Etisalat Egypt will at first offer service to several cities and towns including Cairo, Alexandria, Sharm el-Sheikh and Hurgada, and is expected to sign national roaming agreements with Egypt's other two operators to cover the rest of the country. Reports forecasted that the third mobile phone network could have 10 million subscribers by 2010, of which 3 million would register in the first year of operation. Etisalat Egypt will invest about ₤E 10 billion ($1.8 billion) in 2007, of which ₤E 1.5 billion ($264 million) has already been allocated to establish 150 boosting/connection stations. In conjunction with the new provider, the government plans to introduce Mobile Number Portability, a system that will allow users to switch from one operator to another while retaining their mobile number, using elements of 3G technology. In January 2007, the National Telecommunications Regulatory Agency also awarded Vodafone Egypt a 15-year 3G license for a total of ₤E 3.3 billion ($581 million), of which the company has already paid ₤E 240 million ($42 million).

TE, the state-controlled sole fixed-line provider, currently operates about 10.9 million fixed lines. In 2006, TE announced a profit of ₤E 2.4 billion ($425 million), a 16% increase from 2005, and total revenues of ₤E 9.6 billion ($1.68 million), an 11% increase. These jumps were due to a restructuring plan, for which the company issued a corporate bond to increase capital in 2005. The initial offering was ₤E 2 billion ($346.6 million);

demand, however, reached £E 3.38 billion ($595 million), 70% higher than the initial offer. Foreign investment funds from the U.S., UK, Belgium, and UAE accounted for more than £E 420 million ($74 million) of the issue. TE also raised local call rates in the first quarter of 2006 to reduce an estimated £E 800 million ($141 million) to £E 1 billion ($176 million) per year subsidy for local calls. The new rates are reportedly saving TE at least £E 250 million ($44 million) per year.

While the rates for national long-distance calls remain stable, TE may cut its international call rates later this year if the government offers new licenses to increase competition in the international calling business. According the WTO Basic Telecom Agreement (BTA), TE's monopoly on international calling operations ended in 2005. Though legally expired, the government has not yet granted new licenses for international calling; thus TE has not been forced to improve quality or reduce prices. International call revenues were about 26% of TE's total £E 9.5 billion ($1.7 billion) in revenues, and include incoming international calling fees, mobile international traffic via its 44.66% share in Vodafone, and fixed international calling traffic via its network.

The government has promised to offer new international connectivity licenses "in the near future," since January 2006. The National Telecommunications Regulatory Agency and the Ministry of Communications and Information Technology have said that, when offered, licenses will be available to the 3 mobile operators on the condition that each operator has an Egyptian ISP subsidiary. In order to be eligible, Vodafone Egypt in September 2006 acquired 51 percent of Raya Telecom for £E 104 million ($18 million); MobiNil already has the subsidiary Link.Net. Etisalat Egypt Chairman Mohammed Omran also indicated his company's intention to pursue an international license, but the company does not yet have an ISP subsidiary.

TE continues to expand its international connectivity capacity. In October 2006, TE signed an MOU with India’s Videsh Sanchar Nigam Ltd (VSNL) to build a new submarine cable system linking India with Europe, Africa, Asia and the Middle East. According to VSNL, the India, Middle East and Western Europe cable system will be ready for service by mid-2008.

Orascom Telecom (OT) Holdings, Egypt's largest private telecommunications company and a major mobile phone service provider in Africa and the Middle East, announced in March 2007 that its 2006 net income was $719 million, up 8% from 2005. OT has over 51.5 million subscribers regionally, up 70% from 2005, and is projecting 70 million subscribers by the end of 2007. In addition to Egypt, OT has mobile-phone operations in Algeria, Tunisia, Iraq, Pakistan, Bangladesh and Zimbabwe. Its Algerian subsidiary, Djezzy, contributed 35% of total revenue, followed by Pakistan's fast-growing Mobilink with 23%. In November 2006, OT acquired an additional 7.91% stake in Djezzy from minority shareholders for $399 million, raising OT’s total stake to 95.6 percent.

OT wholly owns IRAQNA, now the number one wireless operator in Iraq. IRAQNA began in 2003 with a two-year contract to operate just in central Iraq, but by 2004 its licensed operations expanded to all areas of the country. Its current investment in Iraq is $280 million, and it had 2.5 million subscribers as of September 2006.

In March 2007, Saudi Arabia's Communications and Information Technology Commission disqualified OT from bidding for the kingdom's third mobile phone license. At the same time, OT launched a bid for a stake in Brazilian telecom outfit Brasil Telecom Participacoes, which current holder Telecom Italia is evaluating. Brasil Telecom is the country's third largest fixed line operator.

Transportation and Infrastructure: 2006 was a challenging year for Egypt's transportation sector; however the sector is witnessing significant reforms and improvements, with developments in civil aviation, maritime transport, railways and road networks. Growing exports and continued growth in the tourism industry will continue to place extra demands on Egypt's transportation infrastructure.

After years of neglect and underinvestment, Egypt's railway system will receive a significant renovation in response to a series of recent fatal rail accidents. In August 2006, fifty five people were killed and nearly 150 injured when a Cairo-bound passenger train traveling at high speed ploughed into the back of another stopped at a station in the Nile Delta region. Barely two weeks later, two trains collided, killing two people and injuring dozens. Among the explanations put forth by the railway was signaling fault (perhaps caused by the theft of overhead electrical cables) and a lack of or poorly implemented safety measures. The collisions and the loss of life brought back memories of unfulfilled government promises to make the railways safe after Egypt’s worst ever rail disaster of 2002: a horrific fire on a train to Upper Egypt that killed 373 people. That disaster focused attention on the state of the railways and given rise to demands for serious repairs of a system used daily by more than 1.2 million passengers, mainly from rural or working class areas, and which transports approximately 11 million tons of goods per year. The Minister of Transport is moving ahead quickly to develop a new safety framework and secure new locomotives, and plans are afoot for enhanced signaling and traffic management systems.

The state-run Egyptian National Railroads (ENR) receives about £E 1.4 billion a year from the government; revenues are significantly less than operating costs. Reports indicate that the railway sector loses about £E 1.6 billion each year, preventing reinvestment in facilities or purchase of spare parts. Two decades of under funding and poor maintenance have placed heavy burdens on its locomotive fleet, which currently has less than 350 out of 700 locomotives in operational order. Egypt has 5,000 kilometers of track that arouse safety concerns because they rely on equipment installed at least 40 years ago. In the Egyptian railway system, signalmen and their ability to communicate with train drivers are key to safety. Many of the collisions of the past have been blamed on human error such as an absent signalman or an exhausted train driver. To reduce the probability of accidents in the short term, ENR has cut the frequency of trains until serious improvements can be made.

After the August 2006 crash, the Ministry of Transportation indicated the need for ₤E 8.5 billion to upgrade this sector. The government has engaged international consultants to look into the re-organization of the railways and advise on safety, rolling stock, signaling and human resources. In addition, the government approved an immediate allocation of about ₤E 5 billion, from revenue generated by the July 2006 of a third mobile telephone license sale, with the remaining from loans and grants. In February 2007, the government received a Qatari grant of $120 million for the purchase of 40 new locomotives, and has also announced a tender for the refurbishment of about 120 of its existing locomotives.

It will take more than new locomotives to upgrade ENR and improve its safety standards, and the Ministry of Transportation has taken on an aggressive restructuring program for the railways. The ministry anticipates that it will need another ₤E 10 billion over the next five years to revamp infrastructure, lay new lines, boost freight capacity, and enter into public-private partnerships for the construction of lines serving the tourism industry – all with the goal of becoming self-sustaining within that period. Some local transport industry experts caution, however, that relying on foreign expertise to overhaul the system, without a national policy to develop local skills and capability, will not lead to long term success, and are pressing the ministry to include local capacity building in its restructuring plan.

Cairo's Metro system consists of two operational lines, with a third in an advanced stage of planning. The metro was constructed by the National Authority for Tunnels (NAT) and currently carries about 2 to 2.5 million passengers per day, a number that exceeds the two lines' planned capacity. In January 2007, the NAT announced the award of over € 55 million to two consortiums for signaling, telecommunications, and electromechanical equipment of the first phase (4.3 kilometers) of Metro line 3, which is forecasted to start in 2012. The new line will link the downtown district of Embaba to Cairo International Airport. Once completed, the line will be 33 kilometers long.

<u>Airport Modernization:</u> Nearly 40% of Egypt’s ten million annual visitors pass through Cairo International Airport, pushing the airport's capacity to its limits and placing strains on its ability to meet customer service standards. Congested facilities also impede cargo traffic expansion. Reports indicated the Ministry of Tourism is targeting an additional one million tourists a year through 2011. The World Trade & Tourism Council, a London-based consultancy, concluded recently that this goal is “objectively impossible to accomplish with the current civil aviation and air transport framework.” It noted that to meet its target, Egypt will need to add an additional 908 international flights and 424 domestic flights per week, a feat the national carrier could not handle alone.

In March 2004, the World Bank approved a $335 million loan to the government for airport modernization projects. Most of the loan ($300 million) went to finance the estimated $400 million construction of a long-planned third terminal at Cairo International Airport. The terminal should open in 2008, and is expected to handle about 11 million passengers annually – essentially doubling passenger handling capacity at the airport. Some significant improvements were already completed before the end of 2006, however, such as the expansion of Terminals 1 and 2, and the construction of a new reception hall, VIP lounge and new duty-free mall. Government officials estimate that traffic for Cairo International Airport will reach 14 million passengers by 2010.

The new terminal for Sharm El Sheik, Egypt's premier beach resort, is expected to be in operation by mid-2007, and was partially financed through a $35 million World Bank loan. The new terminal should double the airport's passenger-handling capacity, handling 7 million passengers per year. The upgrade of Luxor airport was completed in 2005 and currently has a capacity for 25 aircraft per hour to handle an estimated 6 million passengers annually. In 2005, the Japanese International Cooperation Bank also floated a $54 million loan to finance the construction of a new passenger terminal at Borg Al Arab airport outside Alexandria, with an expanded capacity to handle one million passengers and 4,000 tons of cargo per year. To further airport management improvements, the Ministry of Civil Aviation has awarded management contracts to foreign airport operators. On December 27, 2005, it signed an agreement with Germany's Fraport AG to run Cairo airport on a private, revenue-sharing basis. The eight-year contract covers the airport's existing two terminals as well as the planned third terminal. At the same time, the ministry also signed a six-year contract with Aeroports De Paris (ADP) to operate five smaller airports in the tourist centers of Luxor, Aswan, Abu Simbel, Sharm El-Sheikh and Hurghada. The French airport management firm already handles technical operations at Marsa Alam international airport, Egypt's first privately run aviation facility.

In 2005, a charter flight from London inaugurated a build-own-operate-transfer (BOOT) airport in El Alamein, 40 kilometers from the primary resort area of Egypt's Mediterranean coast. A proposed BOOT airport for the Gulf of Suez port of Ain Soukhna is still on the government's agenda. Preliminary studies are being conducted by the NORGIC Group, an airport consultant group from Norway.

The civil aviation sector is regulated by the Egyptian Civil Aviation Authority (ECAA). Although ostensibly an independent body, the ECAA is closely tied to the Ministry of Civil Aviation. In accordance with Law No. 93 of 2003, the government established the Supreme Council for Service Pricing by the Presidential Decree No 314 of 2004. The council is charged with regulating certain aspects of the aviation sector, including transit, take-off and landing fees, as well as the rental rates for buildings and land at airports. In early 2006, ECAA approved the creation of five new civil airlines to boost charter business. The companies were selected from among 14 applicants based on criteria related to security, safety and operating efficiency. Of the five companies, three are wholly Egyptian-owned while two have Italian and joint Egyptian-Arab ownership. Legal requirements dictate that Egypt hold a stake of more than 60% of the total share capital of companies operating scheduled flights.

<u>Egypt Air:</u> Egypt Air, the national carrier's parent company, was converted into a holding company in 2002. To mitigate losses over the following two years, in 2004 the national carrier trimmed its route network and raised prices on domestic routes. In 2005 Boeing concluded a deal with Egypt Air for an order of six 737-800s with purchase

options for an additional six. The deal was worth $850 million at list prices. Egypt Air currently has four Boeing 737-500s, and five 777-200s as part of their mixed fleet of about 42 modern airplanes. On October 1, 2006, the airline received its first 737-800 equipped with a Class 3 Electronic Flight Bag and in December 2006, it received the second plane, with the remaining airplanes joining its fleet through December 2009. Egypt Air has also signed a $750 million long-term lease-purchase agreement for seven new Airbus 330s to replace older Airbus 300/600s. The delivery of the Airbus 330s started in July 2004 and was completed in late 2006. In addition, Egypt Air purchased five additional Airbus 320s for $185 million. Delivery of the Airbus 320s started in October 2003, a few months behind schedule, and was completed in 2005.

After years of losses, Egypt Air has turned a profit since FY 2003-04, but the airline's domestic operations, nearly half of all passenger traffic, have been unable to break even due to high ticket prices and inconvenient flight times. Most domestic flights depart late at night or early in the morning to connect with international flights. Some routes, such as its Cairo to New Valley or Assiut flights, average between 40 to 60% occupancy, while tourist destinations average just over 60% occupancy. According to published studies, domestic flights must exceed 70% occupancy to cover costs.

Currently, Egypt Air is moving ahead with plans to launch a low-cost airline, called Egypt Air Express, to serve its short domestic routes and economize operations, while private carriers are seeking licenses to transform their growing charter operations into regularly scheduled services. Egypt Air Express will primarily serve the domestic market, but could also offer regional services according to market demands. This move allows Egypt Air to better utilize its fleet of jets in more profitable international operations. In September 2006 the airline announced it would sign a contract with Brazilian aircraft manufacturer Embraer for six E-170 jets in a deal worth $170 million. Embraer is expected to deliver the first two 70-seat aircraft by May 2007, with the additional aircraft delivered one per month through September 2007. Egypt Air Express is expected to launch service from Cairo to Sharm Al Sheikh following the arrival of its first two jets, and is planning to add services to Hurghada, Luxor and Aswan. In addition, in February 2007 the Ministry of Aviation established a new company called Smart Aviation Company that will operate 10 passenger planes to serve the business community. The company signed a $50 million contract for the purchase of 3 Cessna Citation Sovereign 680's. The first will be delivered in May 2007 and the last one should be received by the end of 2008.

The ECAA has recently eased two important restrictions, making it easier for private airlines to obtain a license for scheduled services. In 2005, the amount of required paid-in capital was lowered from ₤E 200 million to ₤E 250,000, and foreigners were allowed to invest up to 40% in a private airline company. As for international charter flights, wholly-owned foreign companies are permitted to operate in Egypt. Currently, 5 companies (including foreign and joint ventures) have been established, with two commencing operations in late 2006. The changes encouraged some private airlines companies to apply to the Ministry of Civil Aviation for regular service licenses for domestic and international routes. However, despite these changes, barriers such as high take-off and landing fees, parking fees and ground service fees have made operational costs prohibitively expensive for some airlines to maintain a regular service. As such, Egypt Air has continued to maintain its monopoly on scheduled domestic services. Liberalizing domestic air service and the potential adoption of Open Skies Agreements in the future will ultimately result in positive benefits for everyone, including the national carrier.

Sea Port Modernization: The government has allocated some £E 11 billion during the next five years for port development, which, according to government estimates, is expected to create some 250,000 jobs. The Alexandria Port renovation, completed at a cost of about £E 300 million, has increased handling capacity to 44 million tons/year, up from 32 million tons/year in 2004. The Port of Alexandria handles about 60% of Egypt's incoming and outgoing trade. The renovations included construction of deeper quays to receive larger vessels, the re-designing of storage areas, warehouses and associated infrastructure, installing new fiber optic cables, installation of a more automated management system, and the renovation of the passenger/cruise ship terminal. These renovations have resulted in a smoother flow of goods and services and have combined with reforms in the Customs Authority to produce a sharp decrease in customs clearance times from three to four weeks in 2004 to about one week at present. Still, however, when shipments are required to be approved by the General Organization for Import and Export Control (GOIEC), customs clearance may take between 11 to 20 days.

Hutchison Port Holdings of Hong Kong and a consortium of Saudi investors entered into an agreement with the Alexandria Port Authority to modernize, expand, and manage the container terminals at Alexandria and Dekheila ports on a 25 year BOOT contract. The modernization of quays at Alexandria port was completed in March 2007, and the two container terminals at El Dekheila port are expected to be completed by May 2007. To ease Egypt's dependence on the Port of Alexandria, the government has undertaken a £E 120 million project to improve electronic data management. The project began during the second half of 2006 and is expected to be completed by the end of 2007.

At the port of Damietta, on the Mediterranean coast between Alexandria and the Suez Canal, has benefited from significant private-sector involvement and investment in cargo handling. Processing times have been cut dramatically to about four days (unless GOIEC approval is required). In February 2007, the Minister of Transportation indicated that $1 billion will be invested to transform Damietta into a global hub for advanced carriers, by building a modern container-handling station stretching over one million square meters and with a depth of 18 meters. The first phase of the container station project, which is under an agreement signed in May 2006 between the Ministry of Transport and the Kuwait and Gulf Link Transport Company, is expected to start during the first half of 2007 and be completed within two and a half years.

The port of Ain Soukhna, on the Red Sea about 40 kilometers south of Suez, seeks to capitalize on Egypt's strategic location on the main trade routes between Europe and Asia. Ain Soukhna was also the first fully private port in Egypt, and boasts a sector-leading 48-hour turnaround for clearing goods. The port applies state-of-the-art technology including electronic data interchange and SMS messaging to inform clients of the status of their goods. Sokhna Port is also using bar codes to identify files and folders – a first in the Egyptian port industry – as well as specialized container scanning equipment, electronic banking, and GPS technology for container tracking. Plans and studies for developing additional basins for the port are under discussion that, when finalized, will likely require 2-3 years for construction.

The East Port Said Port is fast becoming the largest in Egypt for container transshipment traffic. The operator, the Suez Canal Container Terminal, is investing $140 million for the second phase to widen the terminal from 1200 meters to 2900 meters, doubling container capacity, which by March 2007 had reached about 1.7 million containers annually. Negotiations between the operator and the Ministry of Transportation are currently taking place regarding extension of the operator's contract and lengthening of the quay to allow for additional unloading area at the port.

ECONOMIC COOPERATION

Regional Initiatives: In March 2007, Egypt and the EU adopted the Neighborhood Policy Action Plan to boost bilateral trade over the next 3-5 years. The EU will support implementation of an Action Plan with a €558 million ($731 million) assistance package. The agreement is expected to open new fields of cooperation between the two countries and enable Egypt to increase agricultural exports to the European market. It will also enable Egypt to participate in some EU programs, and is designed to enhance political co-operation, especially in the areas of human rights, democracy and judicial reform. Under the agreement, EU experts will work with Egyptian counterparts directly in all the fields of cooperation for greater liberalization of trade, services and agriculture. The 25-nation EU bloc is Egypt's top trading partner, with some 43% of Egyptian exports going to the EU and 60% of FDI in Egypt coming from the EU. The EU is also a main provider of development aid for Egypt.

The new EU agreement builds on the EU Association Agreement, which took effect in 2004. That agreement grants Egyptian exporters duty-free and quota-free access to the European market for industrial goods, and expanded access for agricultural products that do not compete directly with European products. The agreement requires Egypt to phase out customs duties on imports from the EU according to four schedules. Tariffs on raw materials and industrial equipment drop to zero three years after the agreement enters into force, i.e. in 2007; on semi-finished goods after 9 years (2013); on consumer goods and finished products after 12 years (2016); and on automobiles after 15 years (2019). The agreement includes €615 million in project assistance grants and €1.1 billion in loans from the EIB designed to help modernize Egyptian industry.

In January 2007, Egypt signed a Trade Agreement with the European Free Trade Association's (EFTA) four members. The accord will liberalize trade in industrial products and processed agricultural products and contains provisions for protecting IPR, competition and technical cooperation. Provisions for services, investments and public procurement will be negotiated later. Egypt's EFTA deal forms part of its efforts to participate in the Euro/Mediterranean Free Trade Area, which is being set up by the EU as part of the Barcelona Declaration on political, economic and social relations with southern Mediterranean countries

Also in January 2007, Egypt and Turkey ratified a bilateral free trade agreement (FTA) deal signed in 2005. Under the agreement, Egyptian industrial exports to Turkey are immediately exempted from customs duties. Customs duties on Turkish exports to Egypt will be dismantled over 12 years according to "the four lists stipulated under the EU-Egypt Association Agreement," starting with raw materials, machinery and equipment before moving on to intermediary goods and, finally, finished products and luxury cars. Trade ties between the two countries have risen in anticipation of the FTA. The volume of bilateral trade was $949 million in 2005, up from $544 million in 2003. Although the balance of trade is largely in favor of Turkey at the moment, with Turkish exports to Egypt at $685 million in 2005, in the first seven months of 2006 Egyptian exports to Turkey were up 44% at $217 million. The aim of the FTA is to boost bilateral trade to $3 billion by 2011 and to bring joint investments to around $2 billion during the course of 2007.

Egypt has trade agreements with nearly every Arab country. In 1998, Egypt began implementing the terms of the Greater Arab Free Trade Area Agreement (GAFTAA), an agreement among 11 Arab League members based on the Arab Common Market Treaty of the 1960s. The GAFTAA called for phasing out existing tariffs by 2008. In 2005, the 11 members agreed to accelerate the tariff phase out and fully eliminate tariffs. Extensive "negative" lists that exclude specific items from tariff elimination, however, impede the effectiveness of this agreement. Two years on, the size of inter-Arab trade has not changed from 8% of total Arab trade, due to negative lists and the continued presence of significant non-tariff barriers in several member countries. In October 2006, the Arab League Council for Economic and Social Studies produced a report highlighting the Arab Economic Strategy that will be implemented through 2020. It stressed the importance of linking inter Arab trade with increasing investment rates in an aim to absorb more of the Arab labor force and to lower unemployment figures.

In February 2004, Egypt signed an FTA (the Aghadir Agreement), with Tunisia, Morocco, and Jordan. The agreement was intended to bring the participants closer, in anticipation of joining the Euro-Mediterranean free trade area by 2010. The agreement commits the parties to remove all tariffs on trade and to intensify economic cooperation by harmonizing standards and customs procedures. The agreement has not yet entered into force, as Morocco has not completed ratification. Tariffs were to be reduced 80% immediately and eliminated completely by 2005, if all parties had ratified and exchanged instruments of ratification in 2004. If instruments are exchanged in 2007, tariffs will be immediately eliminated. Egypt has been a member of the Common Market for Eastern and Southern Africa (COMESA) since 1998. Egypt enjoys tariff-free trade with the 11 members of COMESA, but faces varying tariff levels on trade with the other 9 members.

U.S.-Egypt Economic Cooperation:

Trade and Investment Framework Agreement: Egypt and the U.S. signed a Trade and Investment Framework Agreement (TIFA) in 1999. The TIFA provides a mechanism for identifying and undertaking measures to promote freer trade between Egypt and the U.S. The agreement also established a TIFA Council composed of representatives of both governments, and chaired by a senior USTR official and the Egyptian Ministry of Trade and Industry. The Council first met in November 1999. Subsequent meetings resulted in the establishment of 13 working groups that review technical issues related to all major elements of bilateral trade.

U.S.-Egypt Business Council: The International Trade Administration of the U.S. Department of Commerce established the U.S.-Egypt Presidents' Council (later changed to the U.S.-Egypt Business Council) in 1995 and monitors its activities. Council members, who are American and Egyptian business executives, meet with senior U.S. and Egyptian government officials to offer their views regarding private sector development in Egypt and suggest steps Egypt should take to improve its business climate. The Secretary of Commerce is the U.S. government Co-chair, and the Egyptian Minister of Trade and Industry is the Egyptian government Co-chair. President, CEO and COO of Apache Oil, Steve Farris, is the U.S. business Co-chair. Galal El Zorba, Chairman of Nile Holding, is the Egyptian business Co-chair. The Council members were selected in December 2005, and held their first meeting in Cairo in January 2007. The meeting produced a number of suggested initiatives, including negotiating an updated Bilateral Investment Treaty to supersede the treaty signed by Egypt and the U.S. in 1986.

China-Egypt Economic Cooperation: During the June 2006 visit of Chinese Premier Wen Jiabao to Egypt, the two countries signed 11 trade and business cooperation agreements ranging from manufacturing of communication equipment to cooperation in the hydrocarbons sector. They also announced plans to further develop the Sino-Arab Cooperation Forum. In September 2006, the Egyptian Minister of Trade visited China and secured Chinese/Egyptian joint ventures in Egypt worth a total of $2.7 billion, and according to government statements, received assurance of lower tariffs for Egyptian exports in the future. Among the projects agreed upon during the September visit were a deal with China's National Chemical Engineering Group, the largest state-owned construction company, to set up a 500,000 square-meter industrial zone in Sixth of October City, which will accommodate Egyptian-Chinese joint ventures in light industries such as textiles, footwear and pharmaceuticals; and a pledge from CITIC Group, another one of China's largest state-owned companies, to build an $800 million aluminum smelter in Egypt.

In 2005, bilateral trade between China and Egypt reached $2.145 billion, up 36% from 2004. By the end of 2005, 186 Chinese-funded enterprises had been established in Egypt, with an investment capital of $220 million. China has considerably increased its investment in Egypt in the areas of textiles, stainless steel, oil drilling, chemicals and telecommunications over the past year. Egyptian officials are expecting that China will soon become Egypt's main trade partner, overtaking the U.S. and Europe in the next 5-6 years.

U.S. Economic Assistance: The U.S. government has provided Egypt more than $28 billion in economic assistance since 1978. USAID has been instrumental in putting into place the foundations for economic growth. In addition to infrastructure development (water, wastewater, power, and telecommunications), USAID has helped promote a favorable economic policy environment for private-sector development. Over the years, USAID programs have concentrated on job creation, economic growth and productivity, infrastructure development, education, democracy and governance, health and nutrition, the environment, and natural resource management. Recently, USAID's strategy has focused more on expanding the role of Egypt's private sector to help move Egypt from an assistance-based relationship to a relationship based on bilateral trade and investment. New areas of focus include development of the information-technology sector, strengthening Egypt's capacity for human resource development, trade policy capacity building, financial sector reform, development of micro and small enterprises, and enhancement of Egypt's business and export competitiveness.

Economic assistance levels averaged over $800 million annually from the time of the Camp David accords (1978) until mid-1998. As part of an overall revision in U.S. assistance policy, aid levels have, by mutual agreement, been on a downward glide path since 1999. The USAID budget for Egypt for U.S. FY05 was $535 million and for FY06 $495 million. Current planning foresees economic assistance levels continuing to fall by $40 million per year to a level of $407.5 million by 2009. Much of this assistance from FY 2002 to the present is tied to the government's financial sector reform initiatives, under an MOU signed in March 2005. The U.S. and Egypt are currently discussing the future of assistance after 2009.

U.S. Support for Trade and Investment: The Overseas Private Investment Corporation (OPIC), the U.S. Export-Import Bank (Ex-Im Bank), and the Trade and Development Agency (TDA) are committed to supporting the growth of U.S.-Egyptian bilateral trade and investment. These agencies provide loans, insurance products, and other services, such as support for feasibility studies on major investments involving U.S. inputs. Several business missions from these agencies visit Egypt annually to explore possibilities for increasing their activities in Egypt. Information about Ex-Im Bank, OPIC, and TDA programs is available through their head offices in Washington or through the Embassy (see below). The U.S. Department of Commerce's Foreign Commercial Service (FCS) and the U.S. Department of Agriculture's Foreign Agricultural Service (FAS) provide assistance to U.S. exporters through their offices in Washington and in the Embassy in Cairo. The Embassy's Economic and Political Section also can provide guidance to current and potential American investors and information on current economic conditions in Egypt. See the over leaf of the front page for more information about these services.

POLITICAL ISSUES AFFECTING THE BUSINESS CLIMATE

Nature of Political Relationship with the United States: The U.S. and Egypt enjoy a strong and friendly relationship based on shared mutual interest in Middle East peace, stability and regional security, combating international terrorism, strengthening trade relations, and revitalizing the Egyptian economy. Multinational military exercises, U.S. assistance to Egypt's military modernization program (valued at $1.3 billion annually), and Egypt's role as a contributor to various UN peacekeeping operations continually reinforce the U.S.-Egyptian military relationship.

Political System: President Mubarak won re-election in September 2005 for a fifth six-year term in Egypt's first ever multi-candidate election. The President is empowered to appoint one or more Vice Presidents, the Prime Minister, the Cabinet, and Egypt's 26 provincial governors. There are currently no Vice Presidents. The bicameral legislature includes the law-making People's Assembly and a consultative upper house, the Shura Council.

The National Democratic Party has been the ruling party since its foundation in 1978. In the 2005 parliamentary elections, NDP candidates, combined with independent candidates associated with the NDP to win a majority of seats in the People's Assembly. The number of seats held by independent candidates associated with the banned Muslim Brotherhood also increased substantially, to 20% of total seats. There are 18 other recognized opposition parties, all of them small. A few of these parties have members in the People's Assembly and the Shura Council.

President Mubarak re-appointed 52 year-old Ahmed Nazif as Prime Minister in December 2005, and retained most of the Cabinet appointed in the July 2004 shuffle. Several business leaders were also added to the new Cabinet, including Mohamed Mansour as Minister of Transportation.

In early 2007, President Mubarak submitted several draft amendments to Egypt's constitution to parliament. After parliamentary approval, the amendments were put to a national referendum in March 2007. Voter turnout was low, but the amendment package passed. Among other things, the amendments banned religiously based political parties and gave the president power to detain suspected terrorists indefinitely.

Terrorism/Political Violence: In April 2006 a terrorist attack killed and wounded several foreign tourists and Egyptians in Dahab, a resort town in the Sinai Peninsula. A number of terrorist attacks also occurred in 2005 in Cairo and Sharm el Sheikh and in Taba in 2004. While the potential for additional terrorist attacks does not pose a credible threat to the government, they could threaten the business climate and Egypt's vital tourist industry.

Recent democratic changes have opened a public debate regarding the future of political reform in Egypt. This debate has generated frequent public demonstrations, most of which have remained peaceful. The few incidents involving violence were directed toward the government, not foreigners or foreign investment.

The government has reiterated its interest in foreign investment and its opposition to any boycott of U.S. products, and major threats to foreign investments and entities have not materialized. The overall security atmosphere for U.S. firms operating in Egypt remains excellent.

FURTHER RESOURCES

Additional information on economic and business issues in Egypt can be obtained from a number of sources supported by the U.S. and Egyptian governments, as well as business and research institutions. Below are several websites that may be of further interest. The Embassy takes no responsibility for non-U.S. government sites.

U.S. Government Websites:

www.cairo.usembassy.gov
Homepage of the U.S. Mission to Egypt

www.exim.gov
Export-Import Bank of the United States

www.opic.gov
Overseas Private Investment Corporation

www.usaid.gov
U.S. Agency for International Development

www.tda.gov
Trade and Development Agency

www.ita.doc.gov
Includes all homepages of International Trade Administration (ITA) entities

www.buyusa.gov/egypt/en
Home page of the Commercial Service in Egypt

www.ita.doc.gov/td/tic/
Home page of the Trade Information Center of the U.S. Department of Commerce

www.bea.gov
Bureau of Economic Analysis, U.S. Department of Commerce

www.scitechresources.gov
Catalog of US government science and technology-related websites

Egyptian Government Websites:

www.alhokoma.gov.eg
Egypt's government-on-line homepage, with links to many ministries

www.presidency.gov.eg
Egyptian Presidency

www.sis.gov.eg
State Information Service

www.parliament.gov.eg
Egyptian Parliament

www.idsc.gov.eg
Home page of the Cabinet Information and Decision Support Center

www.cbe.org.eg
Central Bank of Egypt

www.mfti.gov.eg
Ministry of Foreign Trade and Industry

www.investment.gov.eg
Ministry of Investment

www.mfa.gov.eg
Ministry of Foreign Affairs

www.capmas.gov.eg
Central Agency for Public Mobilization and Statistics (CAPMAS)

www.egyptse.com
Cairo and Alexandria Stock Exchange

Non-Governmental Websites:

www.eces.org.eg
Egyptian Center for Economic Studies

www.amcham.org.eg
American Chamber of Commerce in Egypt

www.erf.org.eg
Economic Research Forum for the Arab Countries, Iran and Turkey

www.us-egypt.org
U.S.-Egypt Business Council

www.arableagueonline.org
Arab League Website

www.egyptbic.com
Biotech info Center –Egypt

www.ndp.org.eg
National Democratic Party (NDP) website

www.fgf-egypt.org
Future Generation Foundation website

www.wto.org/english/thewto_e/countries_e/egypt_e.htm
World Trade Organization website - Egypt Page

www.ahram.org.eg
Al Ahram Newspaper

www.elakhbar.org.eg
Al Akhbar Newspaper

www.gn4me.com/alalamalyoum/index.jsp
Al Alam Alyom Newspaper

STATISTICAL ANNEX

COUNTRY DATA

Population: 76.5 million (according to 2006 national census)
Population Growth rate: 1.9%
Religions: Muslim 90% - Christian 10%
Government System: Presidential
Languages: Arabic
Work Week: Sun.–Thurs. (gov't.); Sun.–Thurs. (bus.)

DOMESTIC ECONOMY

National Accounts

Egyptian fiscal year (July-June)
US$ billions unless stated otherwise

	FY02/03	FY03/04	FY 04/05**	FY 05/06
GDP (current prices, ₤E billion)	418	485	539	618
GDP (current prices)*	81.4 (2003)	77.0 (2004)	91.7 (2005)	103.2 (2006)
GDP real growth rate (%)	3.0	4.1	5.1	6.9
GDP/Per Capita (U.S.$)	1197.2 (2003)	1111.1 (2004)	1265.2 (2005)	1432 (2006)
Government Spending/GDP (%)	26.8	26.5	30.0	33.1
Consolidated Fiscal Deficit/GDP	2.4	2.4	3.5	2.0
Inflation (%) ***	7.1	9.5	11.4	4.2
Wholesale Price Index (%, June of each year unless stated otherwise)	18.0	15.9	5.1	5.7
Unemployment (%)	9.9	9.85	10.5	10.9
Foreign Exchange Reserves	14.8	14.8	19.3	22.9
Reserves/months of imports	12	9.7	9.6	9.0
Avg. Exch. Rate for ₤E /$	5.13	6.18	6.01	5.70
End of Period Exch. Rate (June of each year)	6.03	6.22	5.78	5.75
Debt service ratio**** (%)	9.8	9.2	7.9	7.3
Total Foreign Debt/GDP	35.6	38.1	30.0	28.0 (Q3)
U.S. assistance (U.S. Fiscal Year)	1.915	1.875	1.835	1.795
Military	1.3	1.3	1.3	1.3
Economic	0.615	0.575	0.535	.495

* IMF figures
** Some figures revised from last year according to revisions by the sources
*** Inflation figures starting 2002/2003 are revised due to changes in the Urban Price Index
**** Debt Service is ratio of external debt service to current account receipts
Sources: Egyptian government, IMF, World Bank.

Key Sectoral Statistics

	2002	2003	2004	2005	2006
Tourism*					
Revenues (USD million)	3764	4583	6125	6845	7635
Total Arrivals (millions)	5.2	6.0	8.1	8.6	9.8
Total Number of Nights (millions)	32.6	53.1	81.6	85.2	89.0
Regions (% share)					
Europe					74.4
Middle East					13.4
United States					3.3
Africa					3.0
Energy and Petroleum**					
Oil (crude) (avg. thous. barrels/day)	631	618	594	657	640
Gas (billion cubic feet/day)	2.6	3.3	3.55	4.1	5.6
Electricity (million Kilowatt/hour)	83.0	91.4	100.09	100.90	107
Construction*** (million tons)					
Cement (domestic consumption +exports-imports)	27.4 (FY01/02)	28.4 (FY02/03)	28.7 (FY03/04)	33.9 (FY04/05)	36.2 (FY05/06)
Steel (production, rebars)	3.5	3.1	3.1	3.2	3.0
Agriculture****(million metric tons)					
Wheat	6.3	6.5	7.1	8.1	8.3
Rice (milled)	3.7	3.9	3.9	4.0	4.38
Sugar	1.4	1.3	1.3	1.4	1.6
Cotton (thousand metric tons)	315	190	280	250	194

* Ministry of Foreign Trade, Ministry of Tourism
** U.S. Dept. of Energy, Ministry of Petroleum, Ministry of Electricity (Elect. figures for fiscal years, oil and gas figures for calendar years)
*** Ministry of Investment, EFG-Hermes, Ezz Steel
**** U.S. Dept. of Agriculture, cotton is marketing year: Aug.-Sep.

Suez Canal Revenues

(US$ millions)

	FY 02/03	FY03/04	FY04/05	FY 05/06
	2236	2848	3307	3821

TRADE AND INVESTMENT

US$ millions

	FY02/03	FY03/04	FY04/05	FY05/06*
Merchandise Exports	8205	10453	13816	18455
Petroleum and related products	3161	3910	5299	10222
Cotton and related products	199.2	201.6	137.8	146.3
Merchandise Imports	14764	18286	24193	30441
Consumer Goods	2593	2931	3202	3531
Intermediate Goods	4396	5247	6803	8416
Capital Goods	3179	3506	4895	7888

	FY02/03	FY03/04	FY04/05	FY05/06*
Trade Deficit	6559	7834	10377	11986
Services (net)	4907	7318	7843	8191
Tourism Revenues	3796	5475	6430	7235
Suez Canal Revenues	2236	2848	3307	3559
Current Account Balance	1958	3418	2894	1752
Foreign Direct Investment (flow)	701	407	3902	6111
Portfolio Investment (flow)	(405)	(0.2)	0.3	2.0

* Provisional
Source: Central Bank of Egypt and Ministry of Foreign Trade and Industry

U.S. TRADE AND INVESTMENT

Calendar year
US$ millions

	2002	2003	2004	2005	2006
U.S. Exports to Egypt	2868.6	2660.2	3077.8	3168.9	4103.8
U.S. Imports from Egypt	1355.9*	1143.8	1283.8	2091.1	2393.4
US Trade Balance with Egypt	1512.7	1516.4	1682.5	1020.2	1710.4
U.S. FDI (stock)**	2557	2682	3524	4125	NA

*Includes temporary import of Egyptian antiquities museum touring exhibition, valued at $445 million
** Direct investment position on a historical cost basis
Source: U.S. Department of Commerce

PROPOSED STATE BUDGET – AS PRESENTED TO PARLIAMENT

£E billions

	FY03/04	FY04/05	FY 05/06*	FY 06/07**
Total Expenditures	159.60	177.43	187.82	217.27
Wages and Compensation	38.67	41.00	45.8	51.43
Purchase of Goods and Services	9.42	9.94	13.24	15.48
Interest	30.70	38.43	42.61	50.75
Subsidies, Grants and Social Benefits, including:	24.79	29.71	67.02	58.44
Contributions to Pensions	12.00	13.19	11.30	0***
Direct Subsidies (Basic Commodities)	8.19	11.20	9.70	8.64
Direct Subsidies (Other)****	1.39	1.73	22.08 (petroleum	40.00 (petroleum

	FY03/04	FY04/05	FY 05/06*	FY 06/07**
			products) 2.24 (others)	products) 3.49 (others)
Other Expenses	21.04	21.69	18.04	20.94
Purchase of Non-Financial Assets (Investments)	22.85	23.28	21.46	20.24
Total Revenues	102.05	110.86	151.92	163.91
Taxes, including:	67.15	75.76	94.38	105.65
Personal and Corporate Income	27.28	31.57	45.76	53.64
International Trade Transactions	9.23	7.75	8.73	9.60
Goods and Services, *of which* Sales Taxes Property	26.55 12.13 0.784	31.43 13.81 1.03	34.24 15.31 1.17	36.91 16.91 1.20
Grants	5.06	2.85	3.36	3.48
Other Revenues, including: Returns on Ownership Petroleum Authority Surplus Suez Canal Surplus Other Economic Authorities Surplus Public Companies Profits CBE Surplus	29.84 14.55 -2.65 8.29 0.35 1.11 5.81	32.25 17.76 0.154 9.65 0.40 0.25 5.00	54.18 44.38 19.40 10.30 0.50 1.00 0.38	54.78 42.97 18.98 11.78 1.18 2.61 1.00

*Revised/Expected
**Targeted
***The 2006/2007 budget removed the government's contribution to pensions from the subsidies category to the interest category as described in more detail under Fiscal Developments of this report.
****Indirect subsidies for FY 03/04: £E 16.7 billion, FY 04/05: LE 23.4 billion.
Source: Ministry of Finance